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No. 63

In the Supreme Court of the United States

OCTOBER TERM, 1960

EUGENE C. JAMES, PETITIONER

v.

UNITED STATES

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE UNITED STATES

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OPINION BELOW

The opinion of the Court of Appeals (R. 19–22) is reported at 273 F. 2d 5.

JURISDICTION

The judgment of the Court of Appeals (R. 22)[1] was entered on December 29, 1959. A petition for rehearing (R. 23) was denied on February 29, 1960. The petition for writ of certiorari was filed on March 26, 1960, and was granted on May 16, 1960, 362 U.S.

[1] References preceded by "R." are to the printed record; those preceded by "Tr." are to the official court reporter's transcript of proceedings at the trial—in four volumes covering 552 pages—no part of which has been printed. A stipulation has been filed with the Court providing that either party may refer on brief and at the argument to the unprinted portions of the record.

974. (R. 24.) The jurisdiction of this Court is invoked under 28 U.S.C. 1254 (1).

QUESTION PRESENTED

Whether funds misappropriated by petitioner were taxable income to him.

STATUTES INVOLVED

Internal Revenue Code of 1939:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service * * * of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

(26 U.S.C. 1952 ed., Sec. 22(a).)

SEC. 145. PENALTIES.

* * * * * *

(b) *Failure to Collect and Pay Over Tax, or Attempt to Defeat Tax.*—Any person required under this chapter to collect, account for, and pay over any tax imposed by this chapter, who willfully fails to collect or truthfully account for and pay over such tax, and any person who willfully attempts in any manner to evade or defeat any tax imposed by this chapter or the payment thereof, shall, in addi-

tion to other penalties provided by law, be guilty of a felony and, upon conviction thereof, be fined not more than $10,000 or imprisoned for not more than five years, or both, together with the costs of prosecution.

* * * * *

(26 U.S.C. 1952 ed., Sec. 145(b).)

Internal Revenue Code of 1954:

SEC. 61. GROSS INCOME DEFINED.

(a) *General Definition.*—Except as otherwise provided in this subtitle, gross income means all income from whatever source derived * * *.

* * * * *

(26 U.S.C. 61(a).)

SEC. 7201. ATTEMPT TO EVADE OR DEFEAT TAX.

Any person who willfully attempts in any manner to evade or defeat any tax imposed by this title or the payment thereof shall, in addition to other penalties provided by law, be guilty of a felony and, upon conviction thereof, shall be fined not more than $10,000, or imprisoned not more than 5 years, or both, together with the costs of prosecution.

(26 U.S.C. 7201.)

STATEMENT

On December 13, 1957, an indictment in four counts was returned against petitioner in the United States District Court for the Northern District of Illinois, charging wilful attempts to evade and defeat a large part of the income tax due and owing by him and his wife for each of the years 1951 through 1954, in violation of Sections 145(b) and 7201 of the Internal Revenue Codes of 1939 and 1954, respectively. (R.

3–5.) The amounts of petitioner's reported and correct net income and tax liability, as alleged in the indictment, are as follows (omitting cents) (R. 3–5):

Year	Reported		Corrected	
	Income	Tax Liability	Income	Tax Liability
1951	$13,375	$2,353	$123,827	$70,037
1952	23,203	5,997	233,469	166,195
1953	15,223	3,107	407,229	325,323
1954	15,809	2,962	45,371	15,847

After a trial to the court—a jury having been waived—petitioner was found guilty on all counts. (R. 14–16.) On May 11, 1959, he was sentenced to imprisonment for three years—one year on count 1, and two years on each of counts 2, 3 and 4, the sentences on the latter counts to run concurrently with each other but consecutive to the sentence imposed on count 1. (R. 16–17.) The Court of Appeals unanimously affirmed. (R. 19–22.)

The Government does not controvert petitioner's statement of the case. (Pet. Br. 4–15.) The facts—many of which were stipulated (Tr. 22–23, 41–53, 59–68, 196–198, 234–235, 237–238, 300–301, 342–343, 419–420)—were found specially (R. 6–16) by the court and are not in dispute. The unreported income alleged in the indictment consists of funds which petitioner misappropriated, in part from an insurance company and in part from a labor union of which he was an officer. Both the trial and reviewing courts ruled that such funds are taxable gains to petitioner in the years in which the misappropriations occurred.

At all times material, petitioner was General Secretary-Treasurer (initially in an acting capacity) of the Laundry Workers International Union, which had its headquarters in Indianapolis, Indiana. In addition, he was managing trustee of Local No. 46 of the Union which served the Chicago, Illinois area. (R. 7.)

In May 1949, a resolution was adopted, at a convention of the International Union, authorizing the Union's executive board—which was comprised of the officers of the International—to set up a welfare and pension plan for the membership. To effectuate this purpose, the executive board caused a welfare trust to be created in January 1950, known as the Social Security Department of the Laundry Workers International Union. The Social Security Department became a separate division of the International Union. It was governed by six trustees, three of whom were selected by the Union and three by management. Petitioner never served as a trustee of the Social Security Department. (R. 7-8.) Under the welfare plan adopted by the International Union, members were entitled to death benefits and to health and accident insurance coverage. (Tr. 62.)

The welfare plan was financed by contributions from employers. Each local affiliated with the International Union entered into separate contracts with employers providing for payments by the latter into the welfare fund. Pursuant to these contracts, each employer transmitted, monthly, to the local of which its employees were members, a check covering the employers contribution to which was attached a statement

listing the names of the employees and the period covered by the remittance. The various locals, in turn, transmitted the checks and attached statements of coverage to the Social Security Department. (R. 8.)

In the early part of 1950, the Social Security Department entered into group insurance contracts with the Security Mutual Life Insurance Company of Binghamton, New York, which provided health and accident insurance coverage and medical and surgical benefits for members of the International Union. The insurance company appointed Louis B. Saperstein, an insurance broker in Newark, New Jersey, as its general agent to service these policies. The premium rates, however, were fixed by the company. (R. 8–9; Tr. 62.)

Beginning in March 1951, the Social Security Department forwarded, periodically, the correct amounts of all premiums due on the policies to Saperstein, at Newark, New Jersey, by checks drawn to his order. Each check was accompanied by a statement showing the local union for which the payment was made, the number of employees covered, and the dates of their coverage. Saperstein did not remit to the Insurance Company the full amount of all premiums (less his commission) received from the Social Security Department. Huge sums were withheld by him and misappropriated from the insurance company. Saperstein accomplished his misappropriations by arbitrarily reducing the number of employees covered by certain remittances, and consequently the amount of the premium payable, or by deferring the coverage of groups of employees for whom remittances were re-

ceived. Saperstein used a part of the funds withheld in this manner to pay claims made by employees who, under the terms of the policies, were entitled to benefits; the balance was paid over to petitioner by checks drawn to the order of the Laundry Workers International Union and mailed to petitioner, either at his residence in Wheaton, Illinois, or at an office he maintained in the headquarters of Local No. 46 in Chicago. During the years in question, the checks received by petitioner from Saperstein totaled $653,646. (R. 9–10; Tr. 64–68, 73–195.)

The union had no knowledge of the receipt by petitioner of the Saperstein checks. The checks were deposited by petitioner to a "secret" bank account which he maintained, in the name of the Laundry Workers International Union, at the Merchants National Bank in Chicago. During the period in question, all funds deposited to this account were withdrawn by petitioner, in cash, and applied to his own use and benefit. (R. 9–14; Tr. 41, 44–46, 66–68.)

The trial court, noting the provision of New Jersey law which makes an aider and abettor in the commission of crime guilty as a principal, concluded that the sum of $653,646 received by him from Saperstein was embezzled by petitioner from the Security Mutual Life Insurance Company.[2] (R. 10.)

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[2] In 1957, petitioner and Saperstein were indicted in Essex County, New Jersey, for conspiracy to embezzle and for embezzlement of the funds here in question; they were also indicted for conspiracy to obtain money under false pretenses and for the substantive offense. The indictments alleged the embezzlement of some $650,000 and the obtaining under false pretenses of an additional $285,000. (R. 10; Tr. 526–527, 530–

During the years 1951 to 1953, petitioner misappropriated $85,000 from the Laundry Workers International Union in the following manner: In July 1951, he wrote two letters to the Security Mutual Life Insurance Company, in his capacity as secretary-treasurer of the International Union, in which he represented to the Insurance Company that the International Union had incurred, and would continue to incur, substantial expense in promoting and servicing the group insurance policies issued by the Company; he thereupon requested that the union be reimbursed for these expenditures. The Insurance Company responded by agreeing, in September 1951, to pay the International Union the sum of $2,500 a month to defray such expenses, retroactive to January 1951. Pursuant to this agreement, the Insurance Company issued one check, in the amount of $20,000, payable to the International Union, covering the retroactive period; one check, in the amount of $2,500, payable to petitioner, covering the month of September 1951; and monthly checks thereafter, each in the amount of $2,500 payable to petitioner as secretary-treasurer of the International Union. All of these checks were mailed to petitioner, endorsed by stamp, and deposited by him to the "secret" account he maintained in the Merchants National Bank. As previously noted, all sums deposited to this account were withdrawn by petitioner during the years in question and applied

531, 535, 537–540; Def. Exs. 12 and 13: Govt. Exs. 543 and 544.) We have been advised by the office of the prosecutor of Essex County that on September 20, 1960, both petitioner and Saperstein entered pleas of guilty of the offense of conspiracy to embezzle.

by him to his own use and benefit. The sums so received by petitioner in each of the years 1951, 1952 and 1953, amounted to $30,000, $32,500, and $22,500, respectively, totalling $85,000. (R. 10–14.)

The trial court concluded that, under the law of Illinois, this sum of $85,000 was embezzled by petitioner from the Union. (R. 11.)

Subsequent to the years in question, suits were filed, the first in July 1956, by certain beneficiaries of the Social Security Department—who brought class actions—and by the trustees of the Social Security Department, against petitioner, Saperstein, the Security Mutual Life Insurance Company, and the Merchants National Bank, to compel restitution of the misappropriated funds. In July 1958, the various suits were settled by agreement of the parties, which agreement was approved by the Superior Court of Cook County, Illinois, and the United States District Court for the Northern District of Illinois. The agreement was based upon a judicial determination that, as a result of the misappropriations, the Social Security Department was damaged to the extent of $262,137—the amount which it would have received by way of rebates or dividends if all premiums paid on the group policies had been remitted by Saperstein to the Insurance Company. Under the terms of the settlement, the defendants paid over to the Social Security Department the following sums: the Security Mutual Life Insurance Company, $125,000, the

[3] Suits were filed against one or more of the above named parties in the state courts of California, Illinois and New Jersey, and in Federal District Court in Illinois and New Jersey. (Exs. 1–11.)

Security Mutual Life Insurance Company and the Merchants National Bank, $110,000, and petitioner and Saperstein, $13,568.50, each; thereupon, releases were executed relieving the parties defendant from further liability. (Tr. 482–518; Deft. Exs. 1 to 11, inclusive.)

Thus, while petitioner misappropriated approximately three quarters of a million dollars during the years in question, he was required to make restitution in a subsequent year to the extent of $13,568.50.

SUMMARY OF ARGUMENT

I

This case presents the naked legal question whether embezzled funds are taxable gains to the embezzler in the years in which misappropriated. In the Government's view, apart from the case of *Commissioner* v. *Wilcox*, 327 U.S. 404, the decisions of this Court construing the statute have established criteria for determining taxable gains which clearly show that embezzled funds are taxable income to the embezzler.

In construing the statutory definition of gross income in the Internal Revenue Code this Court has proceeded upon the fundamental premise that Congress intended to exercise the full measure of its taxing power. The Court has held that taxable gains are not restricted to receipts from particular sources such as conventional "capital" or "labor"; even "windfalls" are taxable as income. The source from which the receipts are derived does not control. Income is characterized as an "accession to wealth" of

the taxpayer resulting from the economic benefit which the taxpayer realizes from the receipts.

Further, the landmark decisions of this Court demonstrate that the certainty of permanent retention of the receipts by the taxpayer is not a *sine qua non* for a finding of taxable gains. So long as the taxpayer enjoys the benefits of proprietorship, the fact that he acquired the receipts illegally and that he may be required later to repay them to another does not preclude their inclusion in his taxable income. Repayment, if and when it occurs, would diminish the embezzler's income. Technical refinements do not control, for the reach of the taxing acts is determined by the practical substance of transactions and the incidence of economic benefits.

These general principles are applicable to receipts derived from illicit activities. In *Rutkin* v. *United States*, 343 U.S. 130, the fundamental principles of income taxation were applied by the Court in holding that the receipts of extortion are taxable income. It was not deemed material that the extortionist had no bona fide legal or equitable claim to the proceeds or that the victim had a clear right to sue for restitution. The controlling factor was the extortionist's enjoyment of the proceeds from which he derived, in every substantial sense, readily realizable economic value. The case of the embezzler is no different from that of the extortionist. The embezzlement of funds cannot be assimilated to a capital transaction such as a loan because the embezzler in the practical economic sense realizes an "accession to wealth" which the borrower does not.

11

The case of *Commissioner* v. *Wilcox, supra,* which held embezzled funds were not income, represents a departure from the long and consistent line of authority in this Court establishing broad tests for determining taxability of gains. As such, it represents a misapplication of fundamental principles to which the rule of *stare decisis* does not require adherence. In *Rutkin* v. *United States, supra,* which was decided subsequently, this Court expressly limited the *Wilcox* case to its facts, deliberately left it devoid of precedential authority, and reaffirmed the basic principles of income taxation previously established. Having rejected the rationale of *Wilcox*, the Court perforce rejected the holding.

Since *Rutkin*, the vast majority of lower courts considering the question have determined that the *Rutkin* rather than the *Wilcox* reasoning is to be applied in situations logically indistinguishable from *Wilcox*. Thus, their views coincide with those of the Government that the *Wilcox* rationale was rejected in *Rutkin* and could not thereafter be deemed to be the law.

If the *Wilcox* "claim of right" reasoning, rejected in *Rutkin*, were now to be resurrected by this Court, a variety of illicit receipts which have been held to be income by the lower courts would be granted a tax exemption. Moreover, the application of the fundamen-

tal principles of income taxation, insofar as lawful gains are concerned, would become unsettled. And, as *Rutkin* held, there is no room in the statutory language for distinctions in criteria for taxable gains applicable to lawful or unlawful receipts. Any attempt to reconcile *Wilcox* and *Rutkin* based upon asserted differences between extortion and embezzlement would be inconsistent with fundamental principles of the income tax. Such a result might inaugurate a new series of litigations by taxpayers contending that their activities were embraced within the various and disparate state statutes concerning embezzlement. The alternative to these unsatisfactory courses is acknowledgment that *Rutkin* left *Wilcox*, as authority, with no force whatever.

In the Government's view *Rutkin* represents a proper application of fundamental principles, is sound, and should be adhered to here. To follow *Wilcox* now, as petitioner urges, would be to overrule *Rutkin*, which authoritatively declared the controlling legal principles in this area. It would require extreme grounds to justify such an extraordinary result. None is here advanced. Under the economic use and benefit test of *Rutkin* and the other basic decisions of this Court, embezzled funds are clearly income, as the lower courts have generally recognized. The correctness of their view should now be declared by this Court.

ARGUMENT

I

THE COMPREHENSIVE DEFINITION OF TAXABLE INCOME ESTABLISHED IN THIS COURT'S DECISIONS EMBRACES THE GAIN DERIVED BY PETITIONER FROM THE USE AND ENJOYMENT OF THE FUNDS MISAPPROPRIATED BY HIM

The sole issue presented by the petitioner and before this Court is whether certain receipts in excess of $738,000, the fruits of an embezzlement scheme conducted over a period of four years, were taxable gains required to be reported in the income tax returns filed by him for the years in which the misappropriations took place. In *Commissioner* v. *Wilcox*, 327 U.S. 404, upon which petitioner relies, the Court held that embezzled funds were nontaxable receipts. Our contention is that the lower courts, viewing *Wilcox*—with which we shall deal subsequently—as no longer possessing vitality as precedent, and following the controlling decisions of this Court, correctly held that embezzled funds are plainly "gains * * * from any source whatever" and hence subject to tax.

The basic premise on which the Court proceeds in construing the statutory definition of gross income in the Internal Revenue Code[1] has been frequently stated. "The broad sweep of * * * language indicates the purpose of Congress to use the full measure of its taxing power within those definable categories," *Helvering* v. *Clifford*, 309 U.S. 331, 334, and the con-

[1] As the Court noted in *Commissioner* v. *Glenshaw Glass Co.*, 348 U.S. 426, the simplification of the language in the gross income definition of the 1954 Code (§ 61(a)) was not intended to affect its scope. 348 U.S. at 432.

struction of the statute "should be consonant with that purpose." *Ibid.* "The income tax is described in sweeping terms and should be broadly construed in accordance with an obvious purpose to tax income comprehensively." *Commissioner* v. *Jacobson*, 336 U.S. 28, 49. And see further, *e.g.*, *Irwin* v. *Gavit*, 268 U.S. 161, 166; *Douglas* v. *Willcuts*, 296 U.S. 1, 9; *United States* v. *Safety Car Heating Co.*, 297 U.S. 88. The "broad phraseology" reflects "the intention of Congress to tax all gains except those specifically exempted." *Commissioner* v. *Glenshaw Glass Co.*, 348 U.S. 426, 430. Moreover, the Court has ruled that gross income is defined in such breadth that the statute constitutes a "clear legislative attempt to bring the taxing power to bear upon all *receipts* constitutionally taxable * * *." *Id.* at 433. (Emphasis added.)

The Court has removed the restrictions erroneously drawn from the definition in *Eisner* v. *Macomber*, 252 U.S. 189, 207, which seemed to limit income to gain derived from "capital" or "labor". In *Glenshaw Glass, supra*, the taxpayer had received punitive damages for fraud and antitrust violations. As the beneficiary of a penalty imposed upon the payor for his culpable conduct to vindicate public policy, it contended that the receipt in question was a "windfall" not derived from "capital" or "labor" and hence not taxable. Although the Court accepted the taxpayer's characterization, it held the "windfall" taxable because Congress "applied no limitations as to the source of taxable receipts, nor restrictive labels as to their nature." 348 U.S. at 429–430. Since the

punitive damages were "accessions to wealth" which were "clearly realized", over which the taxpayers had "complete dominion", and were not within any express exemptions, they were includible in gross income without regard to their source.

Moreover, a gain otherwise includible in income is taxable when received even though there is no certainty of its permanent retention by the recipient. Thus, receipts over which the taxpayer asserts proprietorship rights are income even though when received their ultimate disposition is subject to the vicissitudes of pending litigation and a court may later determine that the taxpayer "is not entitled to retain the money" and is "liable to restore its equivalent." *North American Oil* v. *Burnet*, 286 U.S. 417, 424. The same result follows when by mistake the taxpayer is paid money to which he is not entitled (*United States* v. *Lewis*, 340 U. S. 590), or extracts money unlawfully (*Rutkin* v. *United States, supra*). See, also, *Healy* v. *Commissioner*, 345 U.S. 278, 282–283. In other words, the contingency that the receipt may not be retained permanently by the taxpayer does not mean that it is any the less a gain when received.

Nor do concepts of the common law of property or title limit the breadth of the definition of gain for federal tax purposes. "Title" has been repeatedly rejected as a limitation on the scope of Section 22(a) of the 1939 Code. Taxation, as the Court has noted, is an "eminently practical" matter. *Tyler* v. *United States*, 281 U.S. 497, 503; *United States* v. *Jacobs*, 306 U.S. 363, 370. Tax liability, it is clear, "may

rest upon the enjoyment by the taxpayer of privileges and benefits so substantial and important as to make it reasonable and just to deal with him as if he were the owner, and to tax him on that basis." *Burnet* v. *Wells*, 289 U.S. 670, 678. Not only ownership, but also "any right or privilege that is a constituent of ownership" may be taxed. *Ibid.* Section 22(a) has been held in other situations to embody an exercise of the power to tax, as income, the acquisition of practical, substantial benefits other than bare legal ownership. *Helvering* v. *Clifford*, 309 U.S. 331; *Helvering* v. *Horst*, 311 U.S. 112. In short, the reach of the taxing acts is to be determined by the practical substance of transactions, the incidence of economic benefits, and by the "actual command over the property taxed—the actual benefit for which the tax is paid," rather than by the technical refinements of title. *Corliss* v. *Bowers*, 281 U.S. 376, 378; *Lucas* v. *Earl*, 281 U.S. 111, 114–115; *Helvering* v. *Horst*, *supra*.

Nor has the illicit nature of an activity under state law been deemed to be a reason for holding that such activity is beyond the federal taxing power. In *United States* v. *Kahriger*, 345 U.S. 22, the Court, upholding the levy by Congress of an occupational tax of $50 per year on persons engaged in the business of accepting wagers against the contention that the tax was merely a device for regulating gambling unlawful under state law, stated: "It is axiomatic that the power of Congress to tax is extensive and sometimes falls with crushing effect on businesses deemed unessential or inimical to the public welfare,

or where, as in dealings with narcotics, the collection of the tax also is difficult." 345 U.S. at 28. Even earlier, in *United States* v. *Constantine*, 296 U.S. 287, it was made clear that an illicit enterprise could be the subject of a tax. There, although the majority declared unconstitutional an *extra* excise tax on liquor dealers operating in violation of state law which substituted for the normal tax on lawful dealers, it was noted that: "The burden of the tax may be imposed alike on the just and the unjust. It would be strange if one carrying on a business the subject of an excise should be able to excuse himself from payment by the plea that in carrying on the business he was violating the law. The rule has always been otherwise." 296 U.S. at 293. Mr. Justice Cardozo would have gone further and validated imposition of a special tax solely on illicit liquor dealers. In a dissenting opinion joined by Justices Brandeis and Stone, he stated (296 U.S. at 297):

> Congress may reasonably have believed that in view of the attendant risks, a business carried on illegally and furtively is likely to yield larger profits than one transacted openly by law-abiding men. Not repression, but payment commensurate with the gains is thus the animating motive. The gains in all likelihood will seldom be exhausted by a tax of $1,000. Congress may also have believed that the furtive character of the business would increase the difficulty and expense of the process of tax collection. The Treasury should have reimbursement for this drain on its resources.

> Apart from either of these beliefs, Congress may have held the view that an excise should be so distributed as to work a minimum of hardship; that an illegal and furtive business, irrespective of the wrongdoing of its proprietor, is a breeder of crimes and a refuge of criminals; and that in any wisely ordered polity, in any sound system of taxation, men engaged in such a calling will be made to contribute more heavily to the necessities of the Treasury than men engaged in a calling that is beneficent and lawful.

It follows that those same principles comprehensively defining taxable income also apply to receipts derived from illicit activities. Such proceeds are taxable income, despite their illicit source, provided they otherwise qualify as "gain". In *United States* v. *Sullivan*, 274 U.S. 259, the first case in which this Court passed upon taxability of gains derived from unlawful sources, it held that gains from illicit traffic in liquor fell within the broad sweep of gross income as defined by Congress. In doing so it rejected the argument that "proceeds of crimes against the laws of the United States cannot be considered as [gross] income" (p. 262) under the revenue laws. Speaking for the Court, Mr. Justice Holmes stated: "We see no * * * reason why the fact that a business is unlawful should exempt it from paying the taxes that if lawful it would have to pay." 274 U.S. at 263. In *Johnson* v. *United States*, 318 U.S. 189, the Court sustained the conviction of a local political leader for evading taxes on payments received from gamblers for protection against police interference. And a conviction for

evading taxes on gambling gains was upheld in *United States* v. *Johnson*, 319 U.S. 503.

These diverse strains of authority, each of which serves to reinforce the breadth of interpretation to be accorded the definition of gross income, were embodied and expressed in *Rutkin* v. *United States*, 343 U.S. 130.* Rutkin, coupling a spurious claim of right, which the Court noted (p. 136) the victim did not believe, with threats of harm to the victim and his family, extorted $250,000 in the taxable year. Holding that extortion proceeds were taxable gains, which Rutkin was required to report as income, the Court affirmed his conviction for tax evasion. The illicit acquisition of the gains was no obstacle. "Unlawful" gains were taxable. That the gains did not accrue from conventional "labor" was not pertinent, for the statute reached gains "derived from any source whatever." (p. 138.) Rutkin's lack of outright ownership, *i.e.*, the defeasible title of the extortionist, was no ground for exemption, for "assailable unlawful gains should [not] be treated differently in this respect from assailable lawful gains." (p. 137.) In sum, the fruit of extortion was income because the extortionist's "control over the cash so received [is] such that" he can "enjoy its use as fully as though his title to it were unassailable," he has "freedom to dispose of [the cash] at will", he "has such control over it that, as a practical matter, ~~and therefore~~ he derives readily realizable economic value from it." (pp. 136–137.)

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* We reserve for consideration later (Point II, *infra*) the intervening decision in *Commissioner* v. *Wilcox*, 327 U.S. 404.

As this Court stated (in terms which are dispositive in this and all unlawful gain cases) (pp. 137-138):

> An *unlawful gain*, as well as a lawful one, constitutes taxable income when its recipient has such control over it that, as a practical matter, he derives readily realizable economic value from it. *Burnet* v. *Wells*, 289 U.S. 670, 678; *Corliss* v. *Bowers*, 281 U.S. 376, 378. * * * [Emphasis supplied.]
>
> Such gains are taxable in the yearly period during which they are realized. This statutory policy is invoked in the interest of orderly administration. "[C]ollection of the revenue cannot be delayed, nor should the Treasury be compelled to decide when a possessor's claims are without legal warrant." *National City Bank* v. *Helvering*, 98 F. 2d 93, 96. There is no adequate reason why assailable unlawful gains should be treated differently in this respect from assailable lawful gains. Certainly there is no reason for treating them more leniently. *United States* v. *Sullivan*, 274 U.S. 259, 263.

Notwithstanding that Rutkin had no bona fide legal or equitable claim to the proceeds and that the victim had a clear right to sue for their recovery, all of which the Court assumed, the extortion receipts were held taxable. Clearly as a matter of "[c]ommon understanding and experience * * * the touchstones for the interpretation of the revenue laws" (*Helvering* v. *Horst*, *supra*, p. 118), Rutkin had income. And the Court's opinion (343 U.S. at 137) cited "many kinds" of unlawful gains that are taxable under § 22(a): bribes, protection payments to racketeers, ransom

money received by kidnappers, graft, black market gains, illegal lotteries, bets, etc.

This voluminous body of authority, which represents a history of successively widening applications of Section 22(a), compels the conclusion that, along with the plunder of extortion and other unlawful gains, the loot of embezzlement is income. The criteria for taxable gains defined by the decisions of this Court are fully satisfied in the case of the embezzler. As is now beyond dispute, the illicit source of the fruit of embezzlement is irrelevant in determining whether taxable income has been realized. What is relevant and controlling is the complete dominion and control enjoyed by the embezzler over his loot, which give him the economic, though not the legal, benefits of ownership. For all practical purposes, the embezzler treats it as *his* money; and it is these significant attributes of ownership and incidence of economic benefits which, under decisions of this Court in diverse situations involving both licit and illicit income, are determinative of taxable income.

Certainly, embezzlement cannot be distinguished from extortion and other crimes on the ground, asserted here by petitioner (Br. 21, 27, 52–53), that an embezzler realizes no gain by his taking because the law imposes upon him an obligation to make restitution. There is nothing unique about the embezzler's legal duty to make restitution. The law imposes a like obligation on all miscreants—the extortioner no less than the embezzler. Moreover, the Court made it plain in *Rutkin* that, absent restitution in the year of receipt, the existence of this legal obligation cannot alter

the fact that the miscreant enjoys, in that accounting period, the economic use and benefit of his ill-gotten gain.

Nor can embezzled funds be likened to the proceeds of a loan. In the case of a loan, the borrower unconditionally manifests and acknowledges his purpose, intention and liability to make repayment. The accession in his assets is accompanied by a corresponding increase in his liabilities, his actual "wealth" remaining the same. The embezzler, on the other hand, treats the funds as his own, and neither acknowledges nor assents to the *in invitum* duty of repayment. He has, as a practical matter, the increase in resources, the "accession to wealth", which no borrower enjoys. The economic aspects of the transactions, which under the statute dominate in the inquiry into gross income, are vitally different.[6] The embezzler's "accession to wealth" is, from an economic standpoint, subject to diminution only to the extent, if any, that he is compelled to make restitution, as the case at bar aptly illustrates. As shown in the Statement (*supra*, pp. 9-10), while petitioner misappropriated about three-quarters of a million dollars during the tax period (1951 to 1954), it was not until 1958 that he was re-

[6] On the deduction side, from the lender's point of view the statute itself recognizes this difference. The lender's taxable income is not reduced by loans made. Only when the loan becomes worthless is a deduction permissible for, until then, the value of the borrower's obligation to repay compensates for the outgo of resources. The victim of embezzlement, by contrast, reduces his income by the amount of the funds taken immediately upon discovery of the theft. His unsatisfied right of recovery from the embezzler normally has no value ascribed to it.

quired to make restitution, and then only in the amount of about $13,500. For all practical purposes, *i.e.*, so far as "readily realizable economic benefit" was concerned, he was as much the "owner" of the money, during the tax years in question, as if he had earned it lawfully—and it would be an extraordinary result, as this Court indicated in *Rutkin*, to accord a wrongdoer preferential tax treatment because his acquisition of the receipts was unlawful.

In summary on this point, apart from the case of *Commissioner* v. *Wilcox, supra,* to be discussed next, we submit that the controlling decisions of this Court compel the conclusion that embezzled funds are income, taxable in the year when received. If, when, and to the extent that the victim recovers back the misappropriated funds, there is of course a reduction in the embezzler's income. But the mere fact that the gain is unlawful, and that it is accompanied by a legal obligation to pay back the misappropriated funds to their rightful owners, does not in any way affect or impair the conclusion that the receipt of the gain and the enjoyment of the economic benefits represented thereby constitute taxable income.

II

SINCE THE *WILCOX* CASE REPRESENTED A DEPARTURE FROM FUNDAMENTAL PRINCIPLES FOR THE DETERMINATION OF GROSS INCOME, ITS REASONING HAS ALREADY BEEN REJECTED BY THE COURT, AND ITS HOLDING IS NO LONGER CONTROLLING ON THE ISSUE HERE

Thus, apart from *Commissioner* v. *Wilcox,* 327 U.S. 404, there is a long, consistent, and undeviating line of

authority establishing broad tests for determining taxability of gains, and that under these tests embezzled funds are clearly taxable income. The problem posed by the *Wilcox* decision, which stands for an opposite conclusion, is comparable to that presented in *Helvering* v. *Hallock*, 309 U.S. 106. There the Court rejected the notion that *stare decisis* is "a mechanical formula of adherence to the latest decision, however recent and questionable, when such adherence involves collision with a prior doctrine more embracing in its scope, intrinsically sounder, and verified by experience" (p. 119). The *Wilcox* case involves collision not only with prior but also with subsequent doctrine, and the Court's language in *Hallock* has even more forceful application here: "[W]e cannot evade our own responsibility for reconsidering in the light of further experience, the validity of distinctions which this Court has itself created. Our problem then is not that of rejecting a settled statutory construction. The real problem is whether a principle shall prevail over its later misapplications. Surely we are not bound by reason or by the considerations that underlie *stare decisis* to persevere in distinctions taken in the application of a statute which, on further examination, appear consonant neither with the purposes of the statute nor with this Court's own conception of it" (p. 122). See also *Girouard* v. *United States*, 328 U.S. 61, 69–70.

In *Wilcox* the Court held that because the embezzler asserted no bona fide legal or equitable claim to the proceeds and was under a definite unconditional obligation to repay them, and because they were there-

fore not received under a "claim of right," embezzled funds were not income. This reasoning is plainly irreconcilable with the many decisions of this Court marking the boundaries of taxable income, both before and after *Wilcox*. See the cases cited *supra*, pp. 14–21. We think it plain that no logical distinction can be drawn for present purposes between the fruits of embezzlement and extortion. It can hardly be disputed now that had the Court in *Rutkin* applied the claim of right test of *Wilcox* it would have had to reach the same result as in *Wilcox*, for an extortioner acquires no more bona fide legal or equitable claim of right to his ill-gotten gain than does an embezzler. Conversely, had the Court in *Wilcox* applied the economic use and benefit test laid down in earlier cases

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The adoption in *Wilcox* of a claim of right test as a touchstone of taxability had no support in prior precedents. What became known in the law of taxation as the "claim of right doctrine" had its genesis in *North American Oil* v. *Burnet*, 286 U.S. 417, cited by the Court in support of its ruling in *Wilcox*. It was by origin and definition a doctrine invoked by the Court in aid of the concept of annual accounting, to determine *when*, not whether, receipts constituted income. In *North American Oil* it was conceded that the receipts in controversy were income; the question before the Court was when the receipts, admittedly income, were to be reported. *Wilcox* was the first and only decision in which the Court applied claim of right as a substantive test of income. Moreover, the claim of right test of *Wilcox* was not even framed in the language of *North American Oil*.

Significantly, when the Court had occasion, subsequent to *Wilcox*, to invoke the claim of right concept—in cases involving assailable lawful gains—it reverted to the language of *North American Oil* and again regarded claim of right as a doctrine to be invoked in aid of the annual accounting concept. *United States* v. *Lewis*, 340 U.S. 590; *Healy* v. *Commissioner*, 345 U.S. 278.

and later followed in *Rutkin*, it would have had to reach the same result as in *Rutkin*, for, in dissipating the embezzled funds in gambling houses, Wilcox, as a practical matter, derived as much economic value from them as did Rutkin from the fruits of his extortion.

The Court in *Rutkin* did not seek to distinguish *Wilcox* on the ground that, while the embezzler obtains no title to the funds taken, the extortionist obtains a defeasible title. And the concomitant difference under state law in the cause of action for restitution accruing to the victim of each (based upon the contrast between void and voidable transactions) was not relied upon.* These differences did not control because such technical refinements do not determine what is or is not taxable income. So far as economic benefit and enjoyment—the controlling considerations—are concerned, the positions of the extortionist and the embezzler are alike.

Instead of attempting to accept the *Wilcox* rationale, but at the same time holding it inapplicable be-

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* *Wilcox* did not clarify the nature of the "unconditional" obligation to repay which prevents inclusion of the receipt in income. The extortionist's liability to his victim seems hardly the less unconditional because the victim when suing for recovery may be required in his complaint to disavow the transaction. The payee of usurious interest or other fees violative of statute may be absolutely liable to the payor for repayment. One who receives a payment by reason of mistake of law or fact or other circumstances causing "unjust enrichment" depending on the jurisdiction may be in a similar position. And the agent who receives a bribe or kickback is liable, not to the third person who paid him, but to his principal for the full amount. Are these instances of an "unconditional obligation to repay" within *Wilcox*? All these questions, which can be consistently settled under the *Rutkin* criteria, invite litigation and divergent results under *Wilcox*.

cause of the differences in the two situations—a course which we believe would not have withstood legal analysis—the Court in *Rutkin*, without even referring to the *Wilcox* rationale, chose instead to follow the general principles, wholly dissimilar from *Wilcox*, declared and applied in the numerous decisions discussed earlier. "We limit that case [*Wilcox*] to its facts," declared the Court in *Rutkin*, 343 U.S. at 138. And the dissenters expressly stated their understanding that the majority had rejected the *Wilcox* interpretation of Section 22(a). *Id.* at 140.

In sum, under the basic principles of income taxation established by the Court, embezzled funds are income; moreover, in the long exegesis of Section 22(a) found in numerous decisions, the reasoning of *Wilcox*, the only case which today would support a contrary holding, has been deliberately left devoid of precedential authority. True, *Wilcox* was not expressly overruled in *Rutkin*. But the Court was neither asked nor did it find the occasion or the necessity for doing so. Here, however, the issue is squarely presented whether, by necessary implication, this Court in *Rutkin* overruled *Wilcox*. We think it clearly did.

Recognizing the departure from fundamental principles represented by the reasoning of the *Wilcox* decision, even prior to *Rutkin* the lower federal courts had proceeded to distinguish *Wilcox*, giving it the most narrow scope and application. See, *e.g.*, *United States* v. *Chapman*, 168 F. 2d 997 (C.A. 7th); *Akers* v. *Scofield*, 167 F. 2d 718 (C.A. 5th), certiorari denied, 335 U.S. 823; *Currier* v. *United States*, 166 F. 2d 346

(C.A. 1st), affirming 70 F. Supp. 219 (D. Mass.); *Cutcliffe* v. *Commissioner,* 163 F. 2d 891 (C.A. 5th), affirming the decision of July 31, 1946 (1946 P-H T.C. Memorandum Decisions, par. 46,184); *United States* v. *Iozia,* 104 F. Supp. 846 (S.D.N.Y.); *Petit* v. *Commissioner,* 10 T.C. 1253.

Since *Rutkin,* the courts of appeals with one exception, have applied the *Rutkin* rule that unlawful gains are taxable income, treating *Wilcox* as in effect having been overruled by *Rutkin.* Thus, in *Macias* v. *Commissioner,* 255 F. 2d 23, 26 (C.A. 7th), the court stated:

> If * * * [the rule of the *Rutkin* case] had been employed in *Wilcox,* we see no escape from the conclusion that the decision in that case would have been different. In our view the Court in *Rutkin* repudiated its holding in *Wilcox;* certainly it repudiated the reasoning by which the result was reached in that case. * * *

In *Briggs* v. *United States,* 214 F. 2d 699, 702 (C.A. 4th), certiorari denied, 348 U.S. 864, the Fourth Circuit observed that "the effect of the doctrine laid down * * * [in *Rutkin*] was 'to depart from the *Wilcox* holding' ". The economic use and benefit test of *Rutkin* has been applied to all unlawful gains, however acquired, including embezzled or misappropriated receipts, with the exception to be noted. *E.g., Prokop* v. *Commissioner,* 254 F. 2d 544 (C.A. 7th) (funds misappropriated from a labor union by an employee of the union); *Briggs* v. *United States, supra* (funds withheld by an employee from the proceeds of sales of property belonging to his employer); *United States*

v. *Wyss*, 239 F. 2d 658 (C.A. 7th) (kickbacks received for procuring transactions with a municipality); *United States* v. *Bruswitz*, 219 F. 2d 59 (C.A. 2d), certiorari denied, 349 U.S. 913 (commercial bribes of money extracted by an employee for the privilege of doing business with his employer); *Davis* v. *United States*, 226 F. 2d 331 (C.A. 6th), certiorari denied, 350 U.S. 965 (funds diverted from corporations by officer stockholder); *Berra* v. *United States*, 221 F. 2d 590 (C.A. 8th), affirmed without discussion of the point, 351 U.S. 131 (kickbacks received by business manager of labor union pursuant to collusive agreement with contractor doing work for the union). In each of the cases cited, the defendants contended that their conduct amounted to embezzlement under state law, and that therefore under *Wilcox* their illicit gains were non-taxable. The *Rutkin* rule was nevertheless applied.* The one exception, a split decision of the Second Circuit, *J. J. Dix, Inc.* v. *Commissioner*, 223 F. 2d 436, 438, certiorari denied, 350 U.S. 894, determined that because the case was "not one involving a receipt under any color of right" the facts brought it closer to *Wilcox* than to *Rutkin* and applied the former decision. For reasons already stated, we think the court's failure there to apply the *Rutkin* decision was error. Generally, however, the Tax Court and the district courts

* Many of these cases illustrate the artificial distinctions to which the lower courts resorted to avoid the impact of the *Wilcox* holding.

have applied the criteria of *Rutkin* rather than that of *Wilcox* to cases of unlawful gains.[10]

Thus, our views as to the effect of *Rutkin* are supported by the opinions of the vast majority of courts which have considered the matter. Virtually all lower courts which have passed upon the question, extrapolating from the decisions of this Court the basic economic benefit test for taxable income, have applied it to a miscellaneous array of unlawful gains and held them all income. In doing so, we think the lower courts have correctly applied *Rutkin*. In our view the rule of the *Rutkin* case is applicable to all gains, however acquired, lawful or unlawful. If this Court were now to revitalize *Wilcox* it would be declaring, in effect, that those cases were decided wrongly and that the gains from such illicit activities were tax exempt. Moreover, a reversion to *Wilcox* could, so far as gains from lawful activities are concerned, becloud the authority and applicability of the comprehensive definition of taxable income evolved in the decision of this Court. But the

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[10] See *e.g.*, *Boucher* v. *Commissioner*, 18 T.C. 710; *Estate of Simmons* v. *Commissioner*, 26 T.C. 409; *Leaf* v. *Commissioner*, 33 T.C.—(No. 125); *Federbush* v. *Commissioner*, 34 T.C.—(No. 77). Indeed, the decision upon which petitioner relies in *United States* v. *Green* (D. Mass.), decided March 31, 1959, where Judge Wyzanski directed an acquittal based upon the *Wilcox* decision, is no longer adhered to by that judge. In a subsequent case Judge Wyzanski declined to follow his *Green* decision, observing "I erred in that case. * * * [It] is quite apparent that my ruling was erroneous * * * I am not going to follow it." *United States* v. *Thomas Worcester* (D. Mass.), Cr. Nos. 57-62W, 57-63W, a prosecution for tax evasion. The quotation is from the court reporter's transcript of proceedings had in the case on August 30, 1960.

Court has made it unmistakably clear that assailable unlawful gains are to be treated no differently than assailable lawful gains, *Rutkin*, at pp. 137–138.[11]

Wilcox and *Rutkin* cannot be reconciled on the basis of asserted technical differences between the extortionist and the embezzler. To do so would be to draw, for tax purposes, unreal distinctions among those whose receipts come from illegal sources. And such a disposition would doubtless inaugurate a new series of attempts by taxpayers, in both civil and criminal cases, to characterize their activities as embraced

[11] Prior to the *Wilcox* decision, the only pertinent administrative material, a General Counsel's Memorandum No. 16572, XV–1 Cum. Bull. 82, which was published in 1936, had held that embezzled funds were taxable gains. Subsequent to *Wilcox*, G.C.M. No. 24945, 1946–2 Cum. Bull. 27, commented that the earlier memorandum was "too broad inasmuch as that memorandum can be construed as holding that embezzlement results in taxable income in all cases", indicated that the "mere act of embezzlement does not of itself result in taxable income", but suggested that "where the owner condones the taking of the property and forgives the indebtedness, taxable income may result to the embezzler, depending on the facts in the particular case." Thus the Internal Revenue Service attempted to construe *Wilcox* narrowly. The failure of the Commissioner expressly to revoke or modify this ruling after the *Rutkin* decision cannot be relied upon by petitioner as showing any administrative "acceptance" of the rationale of *Wilcox*. Obviously, any decision of this Court, to the extent applicable, supersedes a prior General Counsel's Memorandum. The *Rutkin* decision was published in 1952–1 Cum. Bull. 9. Decisions are published in the Cum. Bull. when, among other circumstances, they "revoke, modify, amend, or affect in any manner whatever any published ruling or decision." See Cautionary Notice, 1952–1 Cum. Bull. at page I.

within the varying embezzlement statutes found in the states.[12]

The proper course, we submit, which is consonant with this Court's major decisions in the field of taxation and the one anticipated by virtually every lower court to consider the issue, is to recognize that the *Wilcox* rationale was rejected in *Rutkin*, is unsound, and can no longer be regarded as having vitality. Embezzled funds represent taxable gains. Clear and uniform in its application, the rule of *Rutkin* produces no inequities as between the tax burden borne by lawful and unlawful activities; nor does it propel the federal courts into the labyrinth of varied state concepts of embezzlement. A logical culmination of basic principles, it is sound and should be reaffirmed.

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[12] The task which might then be imposed upon the federal courts can best be comprehended from the following: "Embezzlement is a statutory and not a common-law offense. The statutes vary so much in the different jurisdictions that it is impossible to frame a definition that will apply in all." Clark & Marshall, *Crimes*, p. 796 (6th ed. 1958).

CONCLUSION

For the reasons stated, the judgment below should be affirmed.

Respectfully submitted.

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NOVEMBER 1960.

U. S. GOVERNMENT PRINTING OFFICE: 1960

SUPREME COURT OF THE UNITED STATES

No. 63.—October Term, 1960.

Eugene C. James, Petitioner, v. United States.	On Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit.

[May 15, 1961.]

Mr. Chief Justice Warren announced the judgment of the Court and an opinion in which Mr. Justice Brennan, and Mr. Justice Stewart concur.

The issue before us in this case is whether embezzled funds are to be included in the "gross income" of the embezzler in the year in which the funds are misappropriated under § 22 (a) of the Internal Revenue Code of 1939 [1] and § 61 (a) of the Internal Revenue Code of 1954.[2]

The facts are not in dispute. The petitioner is a union official who, with another person, embezzled in excess of $738,000 during the years 1951 through 1954 from his employer union and from an insurance company with which the union was doing business.[3] Petitioner failed

[1] § 22. Gross Income.

"(a) *General Definition.*—'Gross income' includes gains, profits, and income derived from salaries, wages, or compensation for personal service . . . of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership of use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. . . ." (26 U. S. C. (1952 ed.) § 22 (a).)

[2] § 61. Gross Income Defined.

"(a) *General Definition.*—Except as otherwise provided in this subtitle, gross income means all income from whatever source derived. . . ." (26 U. S. C. § 61 (a).)

[3] Petitioner has pleaded guilty to the offense of conspiracy to embezzle in the Court of Essex County, New Jersey.

to report these amounts in his gross income in those years and was convicted for willfully attempting to evade the federal income tax due for each of the years 1951 through 1954 in violation of § 145 (b) of the Internal Revenue Code of 1939 [4] and § 7201 of the Internal Revenue Code of 1954.[5] He was sentenced to a total of three years imprisonment. The Court of Appeals affirmed. 273 F. 2d 5. Because of a conflict with this Court's decision in *Commissioner* v. *Wilcox*, 327 U. S. 404, a case whose relevant facts are concededly the same as those in the case now before us, we granted certiorari. 362 U. S. 974.

In *Wilcox*, the Court held that embezzled money does not constitute taxable income to the embezzler in the year of the embezzlement under § 22 (a) of the Internal Revenue Code of 1939. Six years later, this Court held, in *Rutkin* v. *United States*, 343 U. S. 130, that extorted money does constitute taxable income to the extortionist in the year that the money is received under § 22 (a) of

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[4] § 145. Penalties.

"(b) *Failure to Collect and Pay Over Tax, or Attempt to Defeat Tax.*—Any person required under this chapter to collect, account for, and pay over any tax imposed by this chapter, who willfully fails to collect or truthfully account for and pay over such tax, and any person who willfully attempts in any manner to evade or defeat any tax imposed by this chapter or the payment thereof, shall, in addition to other penalties provided by law, be guilty of a felony and, upon conviction thereof, be fined not more than $10,000 or imprisoned for not more than five years, or both, together with the costs of prosecution." (26 U. S. C. (1952 ed.) § 145 (b).)

[5] § 7201. Attempt to Evade or Defeat Tax.

"Any person who willfully attempts in any manner to evade or defeat any tax imposed by this title or the payment thereof shall, in addition to other penalties provided by law, be guilty of a felony and, upon conviction thereof, shall be fined not more than $10,000 or imprisoned not more than 5 years, or both, together with the costs of prosecution." (26 U. S. C. § 7201.)

the Internal Revenue Code of 1939. In *Rutkin*, the Court did not overrule *Wilcox*, but stated:

> "We do not reach in this case the factual situation involved in *Commissioner* v. *Wilcox*, 327 U. S. 404. We limit that case to its facts. There embezzled funds were held not to constitute taxable income to the embezzler under § 22 (a)." *Id.*, at 138.[6]

However, examination of the reasoning used in *Rutkin* leads us inescapably to the conclusion that *Wilcox* was thoroughly devitalized.

The basis for the *Wilcox* decision was "that a taxable gain is conditioned upon (1) the presence of a claim of right to the alleged gain and (2) the absence of a definite, unconditional obligation to repay or return that which would otherwise constitute a gain. Without some bona fide legal or equitable claim, even though it be contingent or contested in nature, the taxpayer cannot be said to have received any gain or profit within the reach of § 22 (a)." *Commissioner* v. *Wilcox*, *supra*, at p. 408. Since Wilcox embezzled the money, held it "without any semblance of a bona fide claim of right," *ibid.*, and therefore "was at all times under an unqualified duty and obligation to repay the money to his employer," *ibid.*, the Court found that the money embezzled was not includible within "gross income." But, Rutkin's legal claim was no greater than that of Wilcox. It was specifically found "that petitioner had no basis for his claim . . . and that he obtained it by extortion." *Rutkin* v. *United States*, *supra*, at p. 135. Both Wilcox and Rutkin obtained the money by means of a criminal act; neither had a bona fide claim of right to the funds.[7] Nor was Rutkin's obligation

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[6] The dissenters in *Rutkin* stated that the Court had rejected the *Wilcox* interpretation of § 22 (a). *Id.*, at 140.

[7] The Government contends that the adoption in *Wilcox* of a claim of right test as a touchstone of taxability had no support in the prior

to repay the extorted money to the victim any less than that of Wilcox. The victim of an extortion, like the victim of an embezzlement, has a right to restitution. Furthermore, it is inconsequential that an embezzler may lack title to the sums he appropriates while an extortionist may gain a voidable title. Questions of federal income taxation are not determined by such "attenuated subleties." *Lucas* v. *Earle*, 281 U. S. 111, 114; *Corliss* v. *Bowers*, 281 U. S. 376, 378. Thus, the fact that Rutkin secured the money with the consent of his victim, *Rutkin* v. *United States*, *supra*, at p. 138, is irrelevant. Likewise unimportant is the fact that the sufferer of an extortion is less likely to seek restitution than one whose funds are embezzled. What is important is that the right to recoupment exists in both situations.

Examination of the relevant cases in the courts of appeals lends credence to our conclusion that the *Wilcox* rationale was effectively vitiated by this Court's decision in *Rutkin*.[8] Although this case appears to be the first to

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cases of this Court; that the claim of right test was a doctrine invoked by the Court in aid of the concept of annual accounting, to determine *when*, not *whether*, receipts constituted income. See *North American Oil Co.* v. *Burnet*, 286 U. S. 417; *United States* v. *Lewis*, 340 U. S. 590; *Healy* v. *Commissioner*, 345 U. S. 278. In view of our reasoning set forth below, we need not pass on this contention. The use to which we put the claim of right test here is only to demonstrate that, whatever its validity as a test of *whether* certain receipts constitute income, it calls for no distinction between *Wilcox* and *Rutkin*.

[8] In *Marienfeld* v. *United States*, 214 F. 2d 632, the Eighth Circuit stated, "We find it difficult to reconcile the Wilcox case with the later opinion of the Supreme Court in Rutkin. . . ." *Id.*, at 636. The Second Circuit announced, in *United States* v. *Bruswitz*, 219 F. 2d 59, "It is difficult to perceive what, if anything, is left of the Wilcox holding after Rutkin . . . ." *Id.*, at 61. The Seventh Circuit's prior decision in *Macias* v. *Commissioner*, 255 F. 2d 23, observed, "If this reasoning [of *Rutkin*] had been employed in Wilcox, we see no escape from the conclusion that the decision in that case would have been

arise that is "on all fours" with *Wilcox*, the lower federal courts, in deference to the undisturbed *Wilcox* holding, have earnestly endeavored to find distinguishing facts in the cases before them which would enable them to include sundry unlawful gains within "gross income."[9]

It had been a well-established principle, long before either *Rutkin* or *Wilcox*, that unlawful, as well as lawful, gains are comprehended within the term "gross income." Section II B of the Income Tax Act of 1913 provided that, "the net income of a taxable person shall include gains, profits, and income . . . from . . . the transaction of any *lawful* business carried on for gain or profit; or gains or profits and income, derived from any source whatever. . . ." (Emphasis supplied.) 38 Stat. 167. When the statute was amended in 1916, the one word "lawful" was omitted. This revealed, we think, the obvious intent of that Congress to tax income derived from both legal and illegal sources, to remove the incongruity of having the gains of the honest laborer taxed and the gains of the dishonest immune. *Rutkin* v. *United States*, *supra*, at p. 138; *United States* v. *Sullivan*, 274 U. S. 259, 263.

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different. In our view, the Court in Rutkin repudiated its holding in Wilcox; certainly it repudiated the reasoning by which the result was reached in that case." *Id.*, at 26.

[9] For example, *Kann* v. *Commissioner*, 210 F. 2d 247, was differentiated on the following grounds: the taxpayer was never indicted or convicted of embezzlement; there was no adequate proof that the victim did not forgive the misappropriation; the taxpayer was financially able to both pay the income tax and make restitution; the taxpayer would have likely received most of the misappropriated money as dividends. In *Marienfeld* v. *United States*, *supra*, the court believed that the victim was not likely to repudiate. In *United States* v. *Wyss*, 239 F. 2d 658, the distinguishing factors were that the district judge had not found as a fact that the taxpayer embezzled the funds and the money had not as yet been reclaimed by the victim. See also *Briggs* v. *United States*, 214 F. 2d 699, 702; *Prokop* v. *Commissioner*, 254 F. 2d 544, 554–555. Cf. *J. J. Dix, Inc.*, v. *Commissioner*, 223 F. 2d 436.

Thereafter, the Court held that gains from illicit traffic in liquor are includible within "gross income." *Ibid.* See also *Johnson* v. *United States*, 318 U. S. 189; *United States* v. *Johnson*, 319 U. S. 503. And the Court has pointed out, with approval, that there has been a widespread and settled administrative and judicial recognition of the taxability of unlawful gains of many kinds." *Rutkin* v. *United States*, *supra*, at p. 137. These include protection payments made to racketeers, ransom payments paid to kidnappers, bribes, money derived from the sale of unlawful insurance policies, graft, black market gains, funds obtained from the operation of lotteries, income from race track bookmaking and illegal prize fight pictures. *Ibid.*

The starting point in all cases dealing with the question of the scope of what is included in "gross income" begins with the basic premise that the purpose of Congress was "to use the full measure of its taxing power." *Helvering* v. *Clifford*, 309 U. S. 331, 334. And the Court has given a liberal construction to the broad phraseology of the "gross income" definition statutes in recognition of the intention of Congress to tax all gains except those specifically exempted. *Commissioner* v. *Jacobson*, 336 U. S. 28, 49; *Helvering* v. *Stockholms Enskilda Bank*, 293 U. S. 84, 87–91. The language of § 22 (a) of the 1939 Code, "gains or profits and income derived from any source whatever," and the more simplified language of § 61 (a) of the 1954 Code, "all income from whatever source derived," has been held to encompass all "accessions to wealth, clearly realized, and over which the taxpayers have complete dominion." *Commissioner* v. *Glenshaw Glass Co.*, 348 U. S. 426, 431. A gain "constitutes taxable income when its recipient has such control over it that, as a practical matter, he derives readily realizable economic value from it." *Rutkin* v. *United States*, *supra*, at p. 137. Under these broad principles, we believe that petitioner's contention, that all unlawful gains are tax-

able except those resulting from embezzlement, should fail.

When a taxpayer acquires earnings, lawfully or unlawfully, without the consensual recognition, express or implied, of an obligation to repay and without restriction as to their disposition, "he has received income which he is required to return, even though it may still be claimed that he is not entitled to retain the money, and even though he may still be adjudged liable to restore its equivalent." *North American Oil* v. *Burnet*, *supra*, at p. 424. In such case, the taxpayer has "actual command over the property taxed—the actual benefit for which the tax is paid." *Corliss* v. *Bowers*, *supra*. This standard brings wrongful appropriations within the broad sweep of "gross income"; it excludes loans. When a law-abiding taxpayer mistakenly receives income in one year, which receipt is assailed and found to be invalid in a subsequent year, the taxpayer must nonetheless report the amount as "gross income" in the year received. *United States* v. *Lewis*, *supra*; *Healy* v. *Commissioner*, *supra*. We do not believe that Congress intended to treat a law-breaking taxpayer differently. Just as the honest taxpayer may deduct any amount repaid in the year in which the repayment is made, the Government points out that, "if, when, and to the extent that the victim recovers back the misappropriated funds, there is of course a reduction in the embezzler's income." Brief for the United States, p. 24.[10]

[10] Petitioner urges upon us the case of *Alison* v. *United States*, 344 U. S. 167. But, that case dealt with the right of the victim of an embezzlement to take a deduction, under § 23 (e) and (f) of the 1939 Code, in the year of the discovery of the embezzlement rather than the year in which the embezzlement occurred. The Court held only "that the special factual circumstances found by the District Courts in both these cases justify deductions under I. R. C. § 23 (e) and (f) and the long-standing Treasury Regulations applicable to embezzlement losses." *Id.*, at 170. The question of inclusion of embezzled funds in "gross income" was not presented in *Alison*.

Petitioner contends that the *Wilcox* rule has been in existence since 1946; that if Congress had intended to change the rule, it would have done so; that there was a general revision of the income tax laws in 1954 without mention of the rule; that a bill to change it [11] was introduced in the Eighty-sixth Congress but was not acted upon; that, therefore, we may not change the rule now. But the fact that Congress has remained silent or has re-enacted a statute which we have construed, or that congressional attempts to amend a rule announced by this Court have failed do not necessarily debar us from re-examining and correcting the Court's own errors. *Girouard* v. *United States*, 328 U. S. 61, 69–70; *Helvering* v. *Hallock*, 309 U. S. 106, 119–122. There may have been any number of reasons why Congress acted as it did. *Helvering* v. *Hallock*, *supra*. One of the reasons could well be our subsequent decision in *Rutkin* which has been thought by many to have repudiated *Wilcox*. Particularly might this be true in light of the decisions of the Courts of Appeals which have been riding a narrow rail between the two cases and further distinguishing them to the disparagement of *Wilcox*. See notes 8 and 9, *supra*.

We believe that *Wilcox* was wrongly decided and we find nothing in congressional history since then to persuade us that Congress intended to legislate the rule. Thus, we believe that we should now correct the error and the confusion resulting from it, certainly if we do so in a manner that will not prejudice those who might have relied on it. Cf. *Helvering* v. *Hallock*, *supra*, at 119. We should not continue to confound confusion, particularly when the result would be to perpetuate the injustice of relieving embezzlers of the duty of paying income taxes on the money they enrich themselves with through theft while honest people pay their taxes on every conceivable type of income.

[11] H. R. 8854, 86th Cong., 1st Sess.

But, we are dealing here with a felony conviction under statutes which require that petitioner "willfully" fails to account for his tax or that he "willfully" attempts to evade his obligation. In *Spies* v. *United States*, 317 U. S. 492, 499, the Court said that § 145 (b) of the 1939 Code embodied "the gravest of offenses against the revenues," and stated that willfulness must therefore include an evil motive and want of justification in view of all the circumstances. *Id.*, at 498. Willfulness "involves a specific intent which must be proven by independent evidence and which cannot be inferred from the mere understatement of income." *Holland* v. *United States*, 348 U. S. 121, 139.

We believe that the element of willfulness could not be proven in a criminal prosecution for failing to include embezzled funds in gross income in the year of misappropriation so long as the statute contained the gloss placed upon it by *Wilcox* at the time the alleged crime was committed. Therefore, we feel that petitioner's conviction may not stand and that the indictment against him must be dismissed.

Since MR. JUSTICE HARLAN, MR. JUSTICE FRANKFURTER, and MR. JUSTICE CLARK agree with us concerning *Wilcox*, that case is overruled. MR. JUSTICE BLACK, MR. JUSTICE DOUGLAS, and MR. JUSTICE WHITTAKER believe that petitioner's conviction must be reversed and the case dismissed for the reasons stated in their opinions.

Accordingly, the judgment of the Court of Appeals is reversed and the case is remanded to the District Court with directions to dismiss the indictment.

It is so ordered.

SUPREME COURT OF THE UNITED STATES

No. 63.—October Term, 1960.

Eugene C. James, Petitioner, v. United States.	On Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit.

[May 15, 1961.]

Mr. Justice Black, whom Mr. Justice Douglas joins, concurring in part and dissenting in part.

On February 25, 1946, fifteen years ago, this Court, after mature consideration, and in accordance with what at that time represented the most strongly supported judicial view, held, in an opinion written by Mr. Justice Murphy to which only one Justice dissented, that money secretly taken by an embezzler for his own use did not constitute a taxable gain to him under the federal income tax laws. *Commissioner* v. *Wilcox*, 327 U. S. 404. The Treasury Department promptly accepted this ruling in a bulletin declaring that the "mere act of embezzlement does not of itself result in taxable income," although properly urging that "taxable income may result to the embezzler, depending on the facts in the particular case."[1] During the fifteen years since *Wilcox* was decided, both this Court and Congress, although urged to do so, have declined to change the *Wilcox* interpretation of statutory

[1] G. C. M. No. 24945, 1946-2 Cum. Bull. 27, 28. This was precisely in accord with this Court's statement of the proper rule in the *Wilcox* opinion:

"Taxable income may arise, to be sure, from the use or in connection with the use of such [embezzled] property. But apart from such factors the bare receipt of property or money wholly belonging to another lacks the essential characteristics of a gain or profit within the meaning of § 22 (a)." 327 U. S. at 408.

"income" with respect to embezzlement. In this case however, a majority of the Court overrules *Wilcox*. Only three of the members of the Court who decided the *Wilcox* case are participating in this case—MR. JUSTICE FRANKFURTER, MR. JUSTICE DOUGLAS, and myself. MR. JUSTICE DOUGLAS and I dissent from the Court's action in "overruling" *Wilcox* and from the prospective way in which this is done. We think *Wilcox* was sound when written and is sound now.

I.

We dissent from the way the majority of the Court overrules *Wilcox*. If the statutory interpretation of "taxable income" in *Wilcox* is wrong, then James is guilty of violating the tax evasion statute for the trial court's judgment establishes that he embezzled funds and wilfully refrained from reporting them as income. It appears to us that District Courts are bound to be confused as to what they can do hereafter in tax-evasion cases involving "income" from embezzlements committed prior to this day. Three Justices vote to overrule *Wilcox* under what we believe to be a questionable formula, at least a new one in the annals of this Court, and say that although failure to report embezzled funds has, despite *Wilcox*, always been a crime under the statute, people who have violated this law in the past cannot be prosecuted but people who embezzle funds after this opinion is announced can be prosecuted for failing to report these funds as a "taxable gain." Three other Justices who vote to overrule *Wilcox* say that past embezzlers can be prosecuted for the crime of tax evasion although two of those Justices believe the Government must prove that the past embezzler did not commit his crime in reliance on *Wilcox*. Thus, although it was not the law yesterday, it will be the law tomorrow that funds embezzled hereafter are taxable income; and although past embezzlers could not have

been prosecuted yesterday, maybe they can and maybe they cannot be prosecuted tomorrow for the crime of tax evasion. (The question of the civil tax liability of past embezzlers is left equally unclear.) We do not challenge the wisdom of those of our Brethren who refuse to make the Court's new tax evasion crime applicable to past conduct. This would be good governmental policy even though the *ex post facto* provision of the Constitution has not ordinarily been thought to apply to judicial legislation. Our trouble with this aspect of the Court's action is that it seems to us to indicate that the Court has passed beyond the interpretation of the tax statute and proceeded substantially to amend it.

We realize that there is a doctrine with wide support to the effect that under some circumstances courts should make their decisions as to what the law is apply only prospectively.[2] Objections to such a judicial procedure, however, seem to us to have peculiar force in the field of criminal law. In the first place, a criminal statue that is so ambiguous in scope that an interpretation of it brings about totally unexpected results, thereby subjecting people to penalties and punishments for conduct which they could not know was criminal under existing law, raises serious questions of unconstitutional vagueness.[3] Moreover, for a court to interpret a criminal statute in such a way as to make punishment for past conduct under it so unfair and unjust that the interpretation should be given only prospective application seems to us to be the creation of a judicial crime that Congress might not want to create. This country has never been sympathetic with judge-created crimes. Their rejection under our Constitution was said to have been "long since settled in public

[2] See, for example, *Great Northern R. Co.* v. *Sunburst Oil Co.*, 287 U. S. 358.

[3] See, for example, *United States* v. *L. Cohen Grocery Co.*, 255 U. S. 81.

opinion" even as early as 1812 when the question first reached this Court in *United States* v. *Hudson & Goodwin*, 7 Cranch 32. In that case this Court emphatically declared that the federal courts have no common-law jurisdiction in criminal cases. They are not "vested with jurisdiction over any particular act done by an individual in supposed violation of the peace and dignity of the sovereign power." Rather, "[t]he legislative authority of the Union must first make an act a crime, affix a punishment to it, and declare the Court that shall have jurisdiction of the offence."[4]

In our judgment one of the great inherent restraints upon this Court's departure from the field of interpretation to enter that of lawmaking has been the fact that its judgments could not be limited to prospective application. This Court and in fact all departments of the Government have always heretofore realized that prospective lawmaking is the function of Congress rather than of the courts. We continue to think that this function should be exercised only by Congress under our constitutional system.

II.

We think *Wilcox* was right when it was decided and is right now. It announced no new, novel doctrine. One need only look at the Government's briefs in this Court in the *Wilcox* case to see just how little past judicial support could then be mustered had the Government sought to send Wilcox to jail for his embezzlement under the guise of a tax evasion prosecution. The Government did cite many cases from many courts saying that under the federal income tax law gains are no less taxable because they have been acquired by illegal methods. This Court had properly held long before *Wilcox* that there is no "reason why the fact that a business is unlawful should

[4] 7 Cranch, at 34. And see *United States* v. *Coolidge*, 1 Wheat. 415.

exempt it from paying the taxes that if lawful it would have to pay."[5] We fully recognized the correctness of that holding in *Wilcox:*

> "Moral turpitude is not a touchstone of taxability. The question, rather, is whether the taxpayer in fact received a statutory gain, profit or benefit. That the taxpayer's motive may have been reprehensible or the mode of receipt illegal has no bearing upon the application of § 22 (a)."[6]

The Court today by implication attributes quite a different meaning or consequence to the *Wilcox* opinion. One opinion argues at length the "well-established principle . . . that unlawful, as well as lawful, gains are comprehended within the term 'gross income.'"[7] *Wilcox* did not deny that; we do not deny that. This repeated theme of our Brethren is wholly irrelevant since the *Wilcox* holding in no way violates the sound principle of treating "gains" of honest and dishonest taxpayers alike. The whole basis of the *Wilcox* opinion was that an embezzlement is not in itself "gain" or "income" to the embezzler within the tax sense, for the obvious reason that the embezzled property still belongs, and is known to belong, to the rightful owner. It is thus a mistake to argue that petitioner's contention is "that all unlawful gains are taxable except those resulting from embezzlement."

As stated in *Wilcox*, that case was brought to us because of a conflict among the Circuits. The Ninth Circuit in *Wilcox* had held that embezzled funds were not any more "taxable income" to the embezzler than borrowed funds would have been.[8] The Fifth Circuit, in *McKnight* v. *Commissioner*, had decided the same thing.[9]

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[5] *United States* v. *Sullivan*, 274 U. S. 259, 263.
[6] 327 U. S., at 408.
[7] *Wilcox* v. *Commissioner*, 148 F. 2d 933.
[8] 127 F. 2d 572.

The Eighth Circuit, however, had decided in *Kurrle* v. *Helvering* that embezzled funds were taxable income.[9] Comparison of the three opinions readily shows that the arguments of the Fifth and Ninth Circuits against taxability of such funds were much stronger than the arguments of the Eighth Circuit for such taxability. The whole picture can best be obtained from the court's opinion in *McKnight* v. *Commissioner*, written by Judge Sibley, one of the ablest circuit judges of his time. He recognized that the taxpayer could not rely upon the unlawfulness of his business to defeat taxation if he had made a "gain" in that business. He pointed out, however, that the ordinary embezzler "got no title, void or voidable, to what he took. He was still in possession as he was before, but with a changed purpose. He still had no right nor color of right. He claimed none."[10] Judge Sibley's opinion went on to point out that the "first takings [of an embezzler] are, indeed, nearly always with the intention of repaying, a sort of unauthorized borrowing. It must be conceded that no gain is realized by borrowing, because of the offsetting obligation."[11] Approaching the matter from a practical standpoint, Judge Sibley also explained that subjecting the embezzled funds to a tax would amount to allowing the United States "a preferential claim for part of the dishonest gain, to the direct loss and detriment of those to whom it ought to be restored."[12] He was not willing to put the owner of funds that had been stolen in competition with the United States Treasury Department as to which one should have a preference to get those funds.

[9] 126 F. 2d 723.

[10] 127 F. 2d, at 573.

[11] *Ibid.* The same reasoning can be found in our opinion in *Alison* v. *United States*, 344 U. S. 167, 169–170.

[12] 127 F. 2d, at 574.

It seems to us that Judge Sibley's argument was then and is now unanswerable. The rightful owner who has entrusted his funds to an employee or agent has troubles enough when those funds are embezzled without having the Federal Government step in with its powerful claim that the embezzlement is a taxable event automatically subjecting part of those funds (still belonging to the owner) to the waiting hands of the Government's tax gatherer. We say part of the *owner's* funds because it is on the supposed "gain" from them that the embezzler is now held to be duty-bound to pay the tax and history probably records few instances of independently wealthy embezzlers who have had nonstolen assets available for payment of taxes.

There has been nothing shown to us on any of the occasions when we have considered this problem to indicate that Congress ever intended its income tax laws to be construed as imposing what is in effect a property or excise tax on the rightful owner's embezzled funds, for which the owner has already once paid income tax when he rightfully acquired them. In our view, the Court today does Congress a grave injustice by assuming that it has imposed this double tax burden upon the victim of an embezzlement merely because someone has stolen his money, particularly when Congress has refused requests that it do so. The owner whose funds have been embezzled has done nothing but entrust an agent with possession of his funds for limited purposes, as many of us have frequent occasion to do in the course of business or personal affairs. Ordinarily the owner is not, and has no reason to be, at all aware of an embezzlement until long after the first misuse occurs. If Congress ever did manifest an intention to select the mere fact of embezzlement as the basis for imposing a double tax on the owner, we think a serious question of confiscation in violation of the

Fifth Amendment would be raised. All of us know that with the strong lien provisions of the federal income tax law an owner of stolen funds would have a very rocky road to travel before he got back, without paying a good slice to the Federal Government, such funds as an embezzler who had not paid the tax might, perchance, not have dissipated. An illustration of what this could mean to a defrauded employer is shown in this very case by the employer's loss of some $700,000, upon which the Government claims a tax of $559,000.

It seems to be implied that one reason for overruling *Wilcox* is that a failure to hold embezzled funds taxable would somehow work havoc with the public revenue or discriminate against "honest" taxpayers and force them to pay more taxes. We believe it would be impossible to substantiate either claim. Embezzlers ordinarily are not rich people against whom judgments, even federal tax judgments can be enforced. Judging from the meager settlements that those defrauded were apparently compelled to make with the embezzlers in this very case, it is hard to imagine that the Treasury will be able to collect the more than $500,000 it claims. And certainly the *Wilcox* case does not seem to have been one in which the Government could have collected any great amount of tax. The employer's embezzled $11,000 there went up in gambling houses. The scarcity of cases involving alleged taxes due from embezzlers is another indication that the Government cannot expect to make up any treasury deficits with taxes collected from embezzlers and thieves, especially when the cost to the Government of investigations and court proceedings against suspected individuals is considered. And, as already indicated, to the extent that the Government could be successful in collecting some taxes from embezzlers, it would most likely do so at the expense of the owner whose money had been stolen.

It follows that, except for the possible adverse effect on rightful owners, the only substantial result that one can foresee from today's holding is that the Federal Government will, under the guise of a tax evasion charge, prosecute people for a simple embezzlement. But the Constitution grants power to Congress to get revenue not to prosecute local crimes. And if there is any offense which under our dual system of government is a purely local one which the States should handle, it is embezzlement or theft. The Federal Government stands to lose much money by trying to take over prosecution of this type of local offense. It is very doubtful whether the further congestion of federal court dockets to try such local offenses is good for the Nation, the States or the people. Here the embezzler has already pleaded guilty to the crime of embezzlement in a state court, although the record does not show what punishment he has received. Were it not for the novel formula of applying the Court's new law prospectively, petitioner would have to serve three years in federal prison in addition to his state sentence. This graphically illustrates one of the great dangers of opening up the federal tax statutes, or any others, for use by federal prosecutors against defendants who not only can be but are tried for their crimes in local state courts and punished there. If the people of this country are to be subjected to such double jeopardy and double punishment, despite the constitutional command against double jeopardy, it seems to us it would be far wiser for this Court to wait and let Congress attempt to do it.

III.

The *Wilcox* case was decided fifteen years ago. Congress has met every year since then. All of us know that the House and Senate Committees responsible for our tax laws keep a close watch on judicial rulings interpret-

ing the Internal Revenue Code. Each committee has one or more experts at its constant disposal. It cannot possibly be denied that these committees and these experts are, and have been, fully familiar with the *Wilcox* holding. When Congress is dissatisfied with a tax decision of this Court, it can and frequently does act very quickly to overturn it.[13] On one occasion such an overruling enactment was passed by both the House and Senate and signed by the President all within one day after the decision was rendered by this Court.[14] In 1954 Congress, after extended study, completely overhauled and recodified the Internal Revenue Code. The *Wilcox* holding was left intact. In the Eighty-sixth Congress and in the present Eighty-seventh Congress bills have been introduced to subject embezzled funds to income taxation.[15] They have not been passed. This is not an instance when we can say that Congress may have neglected to change the law because it did not know what

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[13] *E. g., Commissioner* v. *Smith*, 324 U. S. 177 (compensation through exercise of stock option), led to § 218 of the Revenue Act of 1950, adding § 130A to the 1939 Code; *Commissioner* v. *Tower*, 327 U. S. 280; *Lusthaus* v. *Commissioner*, 327 U. S. 293; and *Commissioner* v. *Culbertson*, 337 U. S. 733 (family partnerships), led to § 340 of the Revenue Act of 1951, adding § 191 to the 1939 Code; *United States* v. *Silk*, 331 U. S. 704 ("employees" for purpose of Social Security employment tax), led to P. Law No. 642, 80th Cong., 62 Stat. 438, amending several sections of the 1939 Code; *Commissioner* v. *Estate of Church*, 335 U. S. 632, and *Estate of Spiegel* v. *Commissioner*, 335 U. S. 701 (estate tax), led to P. Law No. 378, 81st Cong., § 7, 63 Stat. 891, 894, amending § 811 (c) of the 1939 Code; *Wilmette Park Dist.* v. *Campbell*, 338 U. S. 411 (amusement tax), led to § 402 of the Revenue Act of 1951, adding § 1701 (d) to the 1939 Code; *Commissioner* v. *Korell*, 339 U. S. 619 (amortization of bond premium), led to § 217 of the Revenue Act of 1950, amending § 125 (b)(1) of the 1939 Code.

[14] 46 Stat. 1516; see 74 Cong. Rec. 7078–7079, 7198–7199.

[15] H. R. 8854, 86th Cong., 1st Sess.; H. R. 312, 87th Cong., 1st Sess.

was going on in the courts or because it was not asked to do so, as was the case in *Helvering* v. *Hallock*.[16] Nor is this a case in which subsequent affirmative congressional action manifested a view inconsistent with our prior decision, as was true in *Girouard* v. *United States*.[17] What we have here instead is a case in which Congress has not passed bills that have been introduced to make embezzled funds taxable and thereby make failure to report them as income a federal crime. For this Court to hold under such circumstances that the inherent ambiguity of legislative inaction gives the Court license to repudiate the long-standing interpretation of the income tax statute and thereby bring additional conduct within the tax evasion criminal statute seems to us to be flagrantly violative of the almost universally accepted axiom that criminal statutes are narrowly and strictly construed. Our Brethren cite no precedent in which this or any other court in the English-speaking world has so deliberately overruled a long-standing prior interpretation of a statute in order to create a crime which up to that time did not exist.

This Court as well as Congress was fully apprised of the various criticisms made in some Courts of Appeals opinions and elsewhere against the *Wilcox* holding, yet it has likewise until today steadfastly refused to overrule that holding during these fifteen years. This has been in the face of the fact that the Government expressly urged

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[16] "To explain the cause of non-action by Congress when Congress itself sheds no light is to venture into speculative unrealities. Congress may not have had its attention directed to an undesirable decision; *and there is no indication that as to the* St. Louis Trust *cases it had*, even by any bill that found its way into a committee pigeon-hole." 309 U. S. 106, 119–120. (Emphasis supplied.)

[17] "This affirmative action taken by Congress in 1942 negatives any inference that otherwise might be drawn from its silence when it reenacted the oath in 1940." 328 U. S. 61, 70.

that we do so in 1955, nine years after *Wilcox* was decided and three years after the decision in *Rutkin* v. *United States*, 343 U. S. 130. On that occasion the Court of Appeals for the Second Circuit, speaking through Judge Frank for himself and Judge Medina, had held in the case of *J. J. Dix, Inc.*, v. *Commissioner* that embezzled funds were not taxable as income, relying wholly on the *Wilcox* decision.[18] Judge Hincks dissented, saying that if the facts of *Dix* were not enough to distinguish it from *Wilcox* he would not follow *Wilcox*. In urging us to grant certiorari, the Government said that the case presented a recurring problem in the administration of the income tax laws. One of the arguments the Government presented for overruling *Wilcox*, strange as it may seem, was that "[s]everal prosecutions have recently been authorized and are now pending in various District Courts, even though the disputed income in those cases apparently came from embezzlements or closely analogous crimes."[19] And the next to the last sentence of its petition was: "In short, the question whether the proceeds of embezzlement, unlike other illegal income, are to enjoy a preferred tax-exempt status, will continue to perplex the lower courts until it is settled by this Court."[20] We denied certiorari.[21] There is surely less reason to repudiate and "devitalize" *Wilcox* now, six years after the Court, as composed at that time, refused to overrule it.

Of course the rule of *stare decisis* is not and should not be an inexorable one. This is particularly true with reference to constitutional decisions involving determinations beyond the power of Congress to change, but Con-

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[18] 223 F. 2d 436.

[19] Petition for certiorari, *Commissioner* v. *Estate of Dix*, No. 363, October Term, 1955, p. 14, n. 6.

[20] *Id.*, at 15.

[21] 350 U. S. 894.

gress can and does change statutory interpretations. It is perfectly proper and right that it should do so when it believes that this Court's interpretation of a statute embodies a policy that Congress is against. But Congress has not taken favorable action on bills introduced to overturn our *Wilcox* holding even after we declined the Government's request to reverse the identical holding in *Dix*, the latter having occurred three years after the decision in *Rutkin* which our Brethren now say may have misled Congress into thinking that we had repudiated the *Wilcox* holding.

It seems to us that we gave the doctrine of *stare decisis* its proper scope in our treatment of this Court's decision in *Federal Baseball Club* v. *National League of Professional Baseball Clubs*, 259 U. S. 200. In that case this Court had held for reasons given that professional baseball was not covered by the antitrust acts. Congress was asked through the years to change the law in this respect but declined to do so. In *Toolson* v. *New York Yankees, Inc.*, 346 U. S. 356, we followed the holding of that case without re-examination of the underlying issues "so far as that decision determines that Congress had no intention of including the business of baseball within the scope of the federal antitrust laws." Later we were asked to extend the *Federal Baseball* case and to hold that the business of boxing could not without congressional action be brought within the antitrust laws. We emphatically declined to do so in *United States* v. *International Boxing Club*, 348 U. S. 236, nor did we overrule *Toolson* in that case, despite strong arguments that the reasoning of the Court in the first baseball case was equally applicable to the business of boxing. We said about the proposed exemption of boxing from the antitrust laws that "[t]heir remedy, if they are entitled to one, lies in further resort to Congress."[22] That case and that statement fit this

[22] 348 U. S., at 244.

case precisely. In fact, as we are about to explain, a far more meaningful distinction can be made between embezzlement and extortion for purposes of this case than it was possible to make between baseball and boxing for purposes of that case, as MR. JUSTICE FRANKFURTER's dissenting opinion in that case demonstrates.

If the Government wants to prosecute the local crime of embezzlement, ostensibly because of "tax evasion," it seems clear to us that it should take its request to Congress which has power to pass on it and which has, to date, refused to do what the Government asks us to do in this case.

IV.

Our Brethren advance as a reason for overruling *Wilcox* the 1952 decision in *Rutkin* v. *United States*, which was decided three years before we denied certiorari in the *Dix* case. They say that "the reasoning used in *Rutkin* leads us inescapably to the conclusion that *Wilcox* was thoroughly devitalized." This follows, to some extent, the statement in the Government's brief that "*Wilcox* and *Rutkin* cannot be reconciled on the basis of asserted technical differences between the extortionist and the embezzler. . . . The proper course, we submit . . . is to recognize that the *Wilcox* rationale was rejected in *Rutkin*, is unsound, and can no longer be regarded as having vitality. Embezzled funds represent taxable gains." [23]

There is no doubt that some of the reasoning in the *Rutkin* opinion rejected some of the reasoning in the *Wilcox* opinion. But this is true only with respect to the broad general standards formulated in the two cases, and such standards of course cannot be accepted as universal panaceas to be mechanically applied to solve all the con-

[23] Brief for the United States, pp. 32-33.

crete problems in cases like these. Moreover, the *Rutkin* opinion expressly purported not to overrule *Wilcox* and specifically said that *Wilcox* was still to govern cases fitting its facts, clearly meaning embezzlement cases.[1] And the Government had not asked in *Rutkin* that *Wilcox* be overruled. Its argument was that *Wilcox* was "inapplicable" to the facts in the *Rutkin* record. The Government's brief went on to emphasize that the record in *Wilcox* showed only the bare receipt of money wholly belonging to another, while Rutkin had received the money "as a result of a bilateral agreement" and, as the Court of Appeals had pointed out, "with a semblance of a *bona fide* claim of right", a conclusion fully substantiated by the testimony of both the petitioner and the Government witness Reinfeld."[2] The Government went on to distinguish *Rutkin* further by pointing out that there was "not the slightest hint in the record" that Rutkin ever had an obligation to repay the funds he took.

After this Court was persuaded by the Government in *Rutkin* to accept its distinctions between *Rutkin* and *Wilcox*, it seems rather odd to have the Government now

[1] "We do not reach in this case the factual situation involved in *Commissioner* v. *Wilcox*, 327 U. S. 404. We limit that case to its facts." There embezzled funds were held not to constitute taxable income to the embezzler under § 22 (a). "The issue here is whether money extorted from a victim with his consent induced solely by harassing demands and threats of violence is included in the definition of gross income under § 22 (a)." 343 U. S., at 138.

[2] Brief for the United States in Opposition to Petition for Certiorari, *Rutkin* v. *United States*, 343 U. S. 130, pp. 13-14. The full sentence in the Court of Appeals opinion from which the Government quoted was: "So he [Rutkin] did receive the money 'with a semblance of a bona fide claim of right' as the embezzler had not in Commissioner of Internal Revenue v. Wilcox, supra, 327 U. S. at page 408, 66 S. Ct. at page 549." *United States* v. *Rutkin*, 189 F. 2d 431, 435.

contend that the two cases are irreconcilable. While we disagreed, we can understand why the majority in *Rutkin* drew the distinctions it did. Although the victim of either embezzlement or extortion ordinarily has a legal right to restitution, the extortion victim, like a blackmail victim, can in a sense be charged with complicity in bringing about the taxable event in that he knowingly surrendered the funds to the extortionist, sometimes in payment of an actual obligation. Unlike the victim of an ordinary theft, he generally knows who has taken the property from him and he consents to the taking though under duress; and unlike most victims of embezzlement, he is able to report the taking to law enforcement officers during the taxable year and his failure to do so might be considered a kind of continuing consent to the extortionist's dominion over the property. The longer he acquiesces the less likely it becomes that the extortion victim ever will demand restitution;[26] but once the victim of an embezzlement finds out that his property has been stolen, he most likely will immediately make efforts to get it back. Thus, although we still think *Rutkin* was wrongly decided for the reasons expressed in the dissenting opinion in that case, we can understand the argument for application of a sort of *caveat emptor* rule to persons who submit to blackmail or extortion, since it is far from certain that they will ever expose themselves by seeking repayment of what they paid out. The dis-

[26] This factual distinction was clearly emphasized in the Court's opinion in *Rutkin*: "[Rutkin] induced Reinfeld to consent to pay the money by creating a fear in Reinfeld that harm otherwise would come to him and to his family. Reinfeld thereupon delivered his own money to petitioner. Petitioner's control over the cash so received was such that, *in the absence of Reinfeld's unlikely repudiation of the transaction and demand for the money's return*, petitioner could enjoy its use as fully as though his title to it were unassailable." *Rutkin* v. *United States*, 343 U. S. 130, 136–137. (Emphasis supplied.)

tinctions between crimes like embezzlement and crimes like blackmail and extortion, therefore, are not merely technical, legalistic "attenuated subtleties" for purposes of this decision, but are differences based upon practicalities such as often underlie the distinctions that have been developed in our law.

In departing from both the *Wilcox* and *Rutkin* decisions today, our Brethren offer no persuasive reasons to prove that their judgment in overruling *Wilcox* is better than that of the Justices who decided that case. It contributes nothing new to the analysis of this problem to say repeatedly that the dishonest man must be subject to taxation just as the honest. As already said, Chief Justice Stone and the others sitting with him on the *Wilcox* Court fully accepted that general principle and we do still. Applying it here, we would say the embezzler should be treated just like the law-abiding, honest borrower who has obtained the owner's consent to his use of the money.[27] It

[27] The analogy between the borrower and the embezzler was lucidly analyzed by Judge Sibley in *McKnight* v. *Commissioner*, 127 F. 2d 572, 573–574.

The several cases relied on by the Court do not, in our judgment, justify imposing a tax upon embezzled money. *Corliss* v. *Bowers*, 281 U. S. 376, involved income accumulating in a trust fund belonging to the taxpayer and over which he retained control. *North American Oil Co.* v. *Burnet*, 286 U. S. 417; *United States* v. *Lewis*, 340 U. S. 590; and *Healy* v. *Commissioner*, 345 U. S. 278, were cases in which the taxpayer had asserted a bona fide, though mistaken, claim of right. In *Burnet*, the taxpayer not only had a bona fide claim to the money taxed, but there had been an adjudication that he was entitled to it, and there was only the tenuous possibility that a competing claimant might later upset that adjudication. The *Lewis* and *Healy* cases involved a tax on payments made and received as a result of mutual mistake, and it was held that the administration of the tax laws on an annual basis need not be upset for the convenience of those who caused the mistaken payments to be made and reported as income. By contrast, the victims do not cause

would be unthinkable to tax the borrower on his "gain" of the borrowed funds and thereby substantially impair the lender's chance of ever recovering the debt. The injury that the Government would inflict on the lender by making the borrower less able to repay the loan surely would not be adequately compensated by telling the lender that he can take a tax deduction for the loss, and it is equally small comfort to the embezzlement victim for the Government, after taking part of his property as a tax on the embezzler, to tell the victim that he can take a deduction for his loss if he has any income against which to offset the deduction. There is, of course, one outstanding distinction between a borrower and an embezzler, and that is that the embezzler uses the funds without the owner's consent. This distinction can be of no importance for purposes of taxability of the funds, however, because as a matter of common sense it suggests that there is, if anything, less reason to tax the embezzler than the borrower. But if this distinction is to be the reason why the embezzlement must be taxed just as "the gains of the honest laborer," then the use of this slogan in this case is laid bare as no more than a means of imposing a second punishment for the crime of embezzlement without regard to revenue considerations, the effect on the rightful owner, or the proper role of this Court when asked to overrule a criminal statutory precedent. The double jeopardy implications would seem obvious.[2]

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embezzlements, and the Government is not misled or inconvenienced under *Wilcox* because the embezzler is always fully aware that the embezzled funds are not rightfully his and presumably will not report otherwise.

[2] See the dissenting opinion in *Bartkus* v. *Illinois*, 359 U. S. 121, 150. It is interesting to note that on July 22, 1959, shortly after the *Bartkus* decision, Illinois, in order to avoid the danger of prosecuting men in both state and federal courts for the same crime, passed a statute making conviction or acquittal in a federal prosecution a

aid discussion of the serious inadvisability for other reasons of thus injecting the Federal Government into local law enforcement can be found in the dissenting opinion in *Rutkin*.

We regret very much that it seems to be implied that the writer of the *Rutkin* opinion and those who agreed to it intended to overrule *Wilcox* when it is manifest that the language the Court used in *Rutkin* was meant to leave precisely the opposite impression. We are sure that our Brethren at that time did not intend to mislead the public, and it would be hard to imagine why they said what they did in the *Rutkin* opinion had they not specifically considered and rejected the possibility of overruling *Wilcox* then and there. We think it is unjustifiable to say nine years after *Rutkin* that it "devitalized" or "repudiated" the *Wilcox* holding when the *Rutkin* opinion said explicitly that *Wilcox* is still the rule as to embezzlement. Congress has seen fit to let both decisions stand, and we think the present Court should do the same.

V.

Even if we were to join with our Brethren in accepting the Government's present contention that *Wilcox* and *Rutkin* cannot both stand, we would disagree as to which of the two decisions should now be repudiated. This is true not only because we would feel less inhibition about narrowing rather than broadening the reach of a previously construed criminal statute. Regardless of such considerations, our conviction that the *Rutkin* case was wrongly decided in this Court remains undiminished and has been further substantiated by the subsequent events

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defense to a state prosecution for the same criminal act. Illinois Laws, 1959, p. 1893, § 1; 38 Ill. Ann. Stat. § 601.1. Thus, while Illinois is moving away from such double prosecutions, this Court is moving even further than *Bartkus* in the direction of authorizing such prosecutions.

in that controversy, which show all the more clearly the deplorable consequences that can result when federal courts subject people who violate state criminal laws to a double or treble prosecution for the state crime under the guise of attempted enforcement of federal tax laws.[29]

For the foregoing reasons, as well as the reasons stated in MR. JUSTICE WHITTAKER'S opinion, we would reaffirm our holding in *Commissioner* v. *Wilcox*, reverse this judgment and direct that the case be dismissed.

[29] The subsequent history of the Rutkin-Reinfeld controversy can, in part, be read in *United States* v. *Rutkin*, 208 F. 2d 647, especially Judge Kalodner's dissenting opinion, at 655; *United States* v. *Rutkin*, 212 F. 2d 641, especially at 644; and *Rutkin* v. *Reinfeld*, 122 F. Supp. 265, reversed, 229 F. 2d 248.

SUPREME COURT OF THE UNITED STATES

No. 63.—October Term, 1960.

Eugene C. James, Petitioner, v. United States.	On Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit.

[May 15, 1961.]

Mr. Justice Clark, concurring in part and dissenting in part as to the opinion of The Chief Justice.

Although I join in the specific overruling of *Commissioner* v. *Wilcox*, 327 U. S. 404 (1946), in The Chief Justice's opinion, I would affirm this conviction on either of two grounds. I believe that the Court not only devitalized *Wilcox*, by limiting it to its facts in *Rutkin* v. *United States*, 343 U. S. 130 (1952), but that in effect the Court overruled that case *sub silentio* in *Commissioner* v. *Glenshaw Glass Co.*, 348 U. S. 426 (1955). Even if that not be true, in my view the proof shows conclusively that petitioner, in willfully failing to correctly report his income, placed no bona fide reliance on *Wilcox*.

SUPREME COURT OF THE UNITED STATES

No. 63.—October Term, 1960.

Eugene C. James, Petitioner, v. United States.	On Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit.

[May 15, 1961.]

Mr. Justice Harlan, whom Mr. Justice Frankfurter joins, concurring in part and dissenting in part as to the opinion of The Chief Justice.

I fully agree with so much of The Chief Justice's opinion as dispatches *Wilcox* to a final demise. But as to the disposition of this case, I think that rather than an outright reversal which his opinion proposes, the reversal should be for a new trial.

I share the view that it would be inequitable to sustain this conviction when by virtue of the *Rutkin-Wilcox* dilemma it might reasonably have been thought by one in petitioner's position that no tax was due in respect of embezzled moneys. For as is pointed out, *Rutkin* did not expressly overrule *Wilcox*, but instead merely confined it "to its facts." Having now concluded that *Wilcox* was wrongly decided originally, the problem in this case thus becomes one of how to overrule *Wilcox* "in a manner that will not prejudice those who might have relied on it." *Ante*, p. —.

It is argued, in reliance on *Spies* v. *United States*, 317 U. S. 492, and *Holland* v. *United States*, 348 U. S. 121, that so long as *Wilcox* remained on the books the element of "willfulness" required in prosecutions of this kind[1] "could not be proven," and hence, that the conviction of

[1] The relevant statutes are set forth in footnotes 1-5 of The Chief Justice's opinion *Ante*, pp. —, —.

this petitioner fails without more. This would mean, I take it, that no future prosecution or past conviction involving tax derelictions of this nature, occurring during the *Wilcox* period, may be brought or allowed to stand. I cannot agree to such a disposition, which, in my view, is warranted by neither principle nor authority and would carry mischievous implications for the future.

The *Spies* and *Holland* cases, which are said to support outright reversal, stand for no more than that where, as here, a criminal tax statute makes "willfulness" an element of the offense, the Government must prove "an evil motive and want of justification in view of all the circumstances" on the part of the defendant, in failing to do what was required of him. While I agree that in the present case this made germane on the issue of willfulness the petitioner's reliance or nonreliance on the continued vitality of the *Wilcox* doctrine,[1] I can find nothing in *Spies* or *Holland* which justifies the view that the mere existence of *Wilcox* suffices alone to vitiate petitioner's conviction *as a matter of law*. If, as appears to have been the case, there was erroneous failure to take that factor into account at the trial on the issue of willfulness, the most that should happen is that petitioner should be given a new trial. This indeed is what *Spies* and *Holland* affirmatively indicate as the right solution of the problem this case presents. In *Spies*, it was said (at pp. 499–500):

> ". . . By way of illustration, and not by way of limitation, we would think affirmative willful attempt

[1] Compare American Law Institute, Model Penal Code, tentative draft No. 4, § 2.04:

> Ignorance or mistake as to a matter of fact or law is a defense if
>
> (a) the ignorance or mistake negatives the purpose, knowledge, belief, recklessness or negligence required to establish a material element of the offense.

may be inferred from conduct such as keeping a double set of books, making false entries or alterations, or false invoices or documents, destruction of books or records, concealment of assets or covering up sources of income, handling of one's affairs to avoid making the records usual in transactions of the kind, and any conduct, the likely effect of which would be to mislead or to conceal. If the tax-evasion motive plays any part in such conduct the offense may be made out even though the conduct may also serve other purposes, such as concealment of other crime.

"In this case there are several items of evidence apart from the default in filing the return and paying the tax which the Government claims will support an inference of willful attempt to evade or defeat the tax. These go to establish that petitioner insisted that certain income be paid to him in cash, transferred it to his own bank by armored car, deposited it, not in his own name but in the names of others of his family, and kept inadequate and misleading records. Petitioner claims other motives animated him in these matters. We intimate no opinion. Such inferences are for the jury. If on proper submission the jury found these acts, taken togther with willful failure to file a return and willful failure to pay the tax, to constitute a willful attempt to evade or defeat the tax, we would consider conviction of a felony sustainable." To the same effect, see *Holland*, *supra*, at p. 139.

In the case at hand, the evidence of devious financial arrangements might well support the inference that petitioner's purpose was not only to commit the embezzlement but also to secrete and immunize his gains from what he considered to be his tax liabilities in respect of those gains. The District Court, as the trier of the facts (there having been no jury), found that petitioner's acts

were "willful and were done in a knowing and conscious attempt to evade and defeat" his tax obligations. But since it does not appear that petitioner's possible reliance on the *Wilcox* doctrine was considered below, *Spies* and *Holland* makes it appropriate for us to send the case back for a new trial. They do not support foreclosing the Government from even undertaking to prove that the petitioner's conduct was "willful" in this respect.

An outright reversal is equally unsound on principle. I take it that our decisions in the tax and any other field for that matter *relate back* to the actual transactions with which they are concerned, and that that is only the normal concomitant of the fact that we do not sit as an administrative agency making rulings for the future, but rather adjudicate actual controversies as to rights and liabilities under the laws of the United States. There can be, I think, two justifications for barring a prosecution of this petitioner in the unusual circumstances presented here: (1) that by reason of *Rutkin* having formally left intact the *Wilcox* doctrine, petitioner did not have due warning of his possible criminal liability; and (2) that the Court, in making new "law" in *Rutkin* should, like the legislature, not impose criminal liability *ex post facto*.

As to the first consideration, where the defendant is charged in a case like this with having "willfully" violated the law, I believe that both reason and authority require no more than that the trier of fact be instructed that it must take into account in determining the defendant's "evil motive and want of justification," *Spies* v. *United States*, 317 U. S., at 498, his possible reliance on *Wilcox*, which not until now has this Court explicitly stated was wrongly decided. As far as fairness to this petitioner is concerned, I do not see why that is not amply accorded by the disposition which *Spies* itself exemplifies.

See p. —, *supra*. On the other hand, if the trier of fact, properly instructed, finds that the petitioner did not act in bona fide reliance on *Wilcox*, but deliberately refused to report income and pay taxes thereon knowing of his obligation to do so and not relying on any exception in the circumstances, I do not see why even the strictest definition of the element of "willfulness" would not have been satisfied. Willfulness goes to motive, and the quality of a particular defendant's motive would not seem to be affected by the fact that another taxpayer similarly situated had a different motive.

An altogether analogous situation was presented in *Murdock* v. *United States*, 290 U. S. 389. In that case the respondent had been convicted of willfully failing to supply information to the Bureau of Internal Revenue in that he relied on the possibility of state prosecution as justifying his invoking the federal privilege against self-incrimination. The Court said in that case:

> ". . . He whose conduct is defined as criminal is one who '*willfully*' fails to pay the tax, make the return, to keep the required records, or to supply the needed information. Congress did not intend that a person, by reason of a bona fide misunderstanding as to his liability for the tax, . . . should become a criminal by his mere failure to measure up to the prescribed standards of conduct. . . .
>
> "It follows that the respondent was entitled to the charge he requested with respect to his good faith and actual belief. Not until this Court pronounced judgment in United States v. Murdock, 284 U. S. 141, had it been definitely settled that one under examination in a federal tribunal could not refuse to answer on account of probable incrimination under state law. The question was involved, but not decided, in Ballman v. Fagin, 200 U. S. 186, 195, and

specifically reserved in Vajtauer v. Comm'r of Immigration, 273 U. S. 103, 113. The trial court could not, therefore, properly tell the jury the defendant's assertion of the privilege was so unreasonable and ill-founded as to exhibit bad faith and establish willful wrongdoing. This was the effect of the instructions given. We think the Circuit Court of Appeals correctly upheld *the respondent's right to have the question of absence of evil motive submitted to the jury.* . . ." (Emphasis supplied.)

It would seem that precisely the same disposition is in order in this case. Nor do I think that distinctions in terms of the nature of the defendant's legal misapprehension, its degree, its justifiability, or its source are either warranted or would be manageable as a basis for deciding future cases.

Coming now to the other possible rationale for barring the prosecution of this petitioner, it might be argued that petitioner at the time he failed to make his return was not under any misapprehension as to the law, but indeed that at the time and under the decisions of this Court his view of the law was entirely correct. The argument not only seems to beg the question, but raises further questions as to the civil liability of one situated in the circumstances of this petitioner. Petitioner's obligation here derived not from the decisions of this or any other court, but from the Act of Congress imposing the tax. It is hard to see what further point is being made, once it is conceded that petitioner, if he was misled by the decisions of this Court, is entitled to plead in defense that misconception. Only in the most metaphorical sense has the law changed: the decisions of this Court have changed, and the decisions of a court interpreting the acts of a legislature have never been subject to the same limitations which are imposed on legislatures themselves, United States Constitution,

Art. I, §§ 9, 10, forbidding them to make any *ex post facto* law[3] and in the case of States to impair the obligations of a contract. *Ross* v. *Oregon*, 227 U. S. 150; *New Orleans Water Works Co.* v. *Louisiana Sugar Refining Co.*, 125 U. S. 18.

The proper disposition of this case, in my view, is to treat as plain error, Fed. Rules Crim. Proc. 52 (b), the failure of the trial court as trier of fact to consider whatever misapprehension may have existed in the mind of the petitioner as to the applicable law, in determining whether the Government had proved that petitioner's conduct had been willful as required by the statute. On that basis I would send the case back for a new trial.

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[3] Aside from problems of warning and specific intent, the policy of the prohibition against *ex post facto* legislation would seem to rest on the apprehension that the legislature, in imposing penalties on past conduct, even though the conduct could properly have been made criminal and even though the defendant who engaged in that conduct in the past believed he was doing wrong (as for instance, when the penalty is increased retroactively on an existing crime), may be acting with a purpose not to prevent dangerous conduct generally but to impose by legislation a penalty against specific persons or class of persons. That this policy is inapplicable to decisions of the courts seems obvious: their opportunity for discrimination is more limited than the legislature's, in that they can only act in construing existing law in actual litigation. Given the divergent pulls of flexibility and precedent in our case law system, it is disquieting to think what perplexities and what subtleties of distinction would be created in applying this policy, which so properly limits legislative action, to the decisions of the courts.

SUPREME COURT OF THE UNITED STATES

No. 63.—October Term, 1960.

Eugene C. James, Petitioner, v. United States. | On Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit.

[May 15, 1961.]

Mr. Justice Whittaker, whom Mr. Justice Black and Mr. Justice Douglas join, concurring in part and dissenting in part.

The starting point of any inquiry as to what constitutes taxable income must be the Sixteenth Amendment, which grants Congress the power "to lay and collect taxes on incomes, from whatever course derived . . . ." It has long been settled that Congress' broad statutory definitions of taxable income were intended "to use the full measure of [the Sixteenth Amendment's] taxing power." *Helvering* v. *Clifford*, 309 U. S. 331, 334; *Douglas* v. *Willcuts*, 296 U. S. 1, 9. Equally well settled is the principle that the Sixteenth Amendment "is to be taken as written and is not to be extended beyond the meaning clearly indicated by the language used." *Edwards* v. *Cuba Railroad*, 268 U. S. 628, 631.[1] The language of the Sixteenth Amendment, as well as our prior controlling decisions, compel me to conclude that the question now before us—whether an embezzler receives taxable income at the time of his unlawful taking—must be answered negatively.

[1] "A proper regard for its genesis, as well as its very clear language, requires also that [the Sixteenth] Amendment shall not be extended by loose construction . . . . Congress cannot by any definition [of income] it may adopt conclude the matter, since it cannot by legislation alter the Constitution, from which alone it derives its power to legislate, and within whose limitations alone that power can be lawfully exercised." *Eisner* v. *Macomber*, 252 U. S. 189, 206.

Since the prevailing opinion reaches an opposite conclusion, I must respectfully dissent from that holding, although I concur in the Court's judgment reversing petitioner's conviction. I am convinced that *Commissioner* v. *Wilcox*, 327 U. S. 404, which is today overruled, was correctly decided on the basis of every controlling principle used in defining taxable income since the Sixteenth Amendment's adoption.

The CHIEF JUSTICE's opinion, although it correctly recites *Wilcox's* holding that "embezzled money does not constitute taxable income to the embezzler *in the year of the embezzlement*" (emphasis added), fails to explain or to answer the true basis of that holding. *Wilcox* did not hold that embezzled funds may never constitute taxable income to the embezzler. To the contrary, it expressly recognized that an embezzler may realize a taxable gain to the full extent of the amount taken, if and when it ever becomes *his*. The applicable test of taxable income, *i. e.*, the "presence of a claim of right to the alleged gain," of which *Wilcox* spoke, was but a correlative statement of the factor upon which the decision placed its whole emphasis throughout, namely, the "absence of a definite, unconditional obligation to repay or return [the money]." 327 U. S., at 408. In holding that this test was not met at the time of the embezzlement, the *Wilcox* opinion repeatedly stressed that the embezzler had no "bona fide legal or equitable claim" to the embezzled funds, *ibid.*; that the victim never "condoned or forgave the taking of the money and still holds him liable to restore it," *id.*, at 406; and that the "debtor-creditor relationship was definite and unconditional." *Id.*, at 409. These statements all express the same basic fact—the fact which is emphasized most strongly in the opinion's conclusion explaining why the embezzler had not yet received taxable income: "Sanctioning a tax in the circumstances before us would serve only to give the United States an unjustified prefer-

ence as to part of the money which *rightfully and completely belongs to the taxpayer's employer.*" *Id.*, at 410. (Emphasis added.)

However, *Wilcox* plainly stated that "if the unconditional indebtedness is cancelled or retired, taxable income may adhere, under certain circumstances, to the taxpayer." 327 U. S., at 408. More specifically, it recognized that had the embezzler's victim "condoned or forgiven any part of the [indebtedness]; the [embezzler] might have been subject to tax liability to that extent," *id.*, at 410; *i. e.*, in the tax year of such forgiveness.

These statements reflect an understanding of, and regard for, substantive tax law concepts solidly entrenched in our prior decisions. Since our landmark case of *United States* v. *Kirby Lumber Co.*, 284 U. S. 1, it has been settled that upon a discharge of indebtedness by an event other than full repayment, the debtor realizes a taxable gain in the year of discharge to the extent of the indebtedness thus extinguished. Such gains are commonly referred to as ones realized through "bargain cancellations" of indebtedness, and it was in this area, and indeed, in *Kirby Lumber Co.* itself, that the "accession" theory or "economic gain" concept of taxable income, upon which the CHIEF JUSTICE's opinion today mistakenly relies, found its genesis. In that case, the taxpayer, a corporation, had reduced a portion of its debt, with a corresponding gain in assets, by purchasing its bonds in the open market at considerably less than their issue price. Mr. Justice Holmes, who wrote the Court's opinion, found it unnecessary to state the elementary principle that, so long as the bonds remained a fully enforceable debt obligation of the taxpayer, there could be no taxable gain. However, when the taxpayer retired the debt by purchasing the bonds for less than their face value, it "made a clear [taxable] gain" and "realized within the year an accession to income" in the amount of its bargain. 284 U. S., at 3.

This doctrine has since been reaffirmed and strengthened by us, see, *e. g.*, *Helvering* v. *American Chicle Co.*, 291 U. S. 426; *Commissioner* v. *Jacobson*, 336 U. S. 28, and by the lower federal courts in numerous decisions involving a variety of "bargain cancellations" of indebtedness, as by a creditor's release condoning or forgiving the indebtedness in whole or in part,[2] or by the running of a Statute of Limitations barring the legal enforceability of the obligation.[3] In none of these cases has it been suggested that a taxable gain might be realized by the debtor at any time *prior* to the effective date of discharge, and as *Wilcox* recognized, there is no rational basis on which to justify such a rule where the debt arises through embezzlement.

An embezzler, like a common thief, acquires not a semblance of right, title, or interest in his plunder, and whether he spends it or not, he is indebted to his victim in the full amount taken as surely as if he had left a signed promissory note at the scene of the crime. Of no consequence from any standpoint is the absence of such formalities as (in the words of the prevailing opinion) "a consensual recognition, express or implied, of an obligation to repay." The law readily implies whatever "consensual recognition" is needed for the rightful owner to assert an immediately ripe and enforceable obligation of repayment against the wrongful taker. These principles are not "attenuated subtleties" but are among the clearest and most easily applied rules of our law. They exist to

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[2] See, *e. g.*, *Spear Box Co.* v. *Commissioner*, 182 F. 2d 844 (C. A. 2d Cir.); *Helvering* v. *Jane Holding Corp.*, 109 F. 2d 933 (C. A. 8th Cir.); *Pacific Magnesium, Inc.*, v. *Westover*, 86 F. Supp. 644 (D. C. S. D. Cal.).

[3] See, *e. g.*, *Schweppe* v. *Commissioner*, 168 F. 2d 284 (C. A. 9th Cir.); *North American Coal Corp.* v. *Commissioner*, 97 F. 2d 325 (C. A. 6th Cir.); *Securities Co.* v. *United States*, 85 F. Supp. 532 (D. C. S. D. N. Y.).

protect the rights of the innocent victim, and we should accord them full recognition and respect.

The fact that an embezzler's victim may have less chance of success than other creditors in seeking repayment from his debtor is not a valid reason for us further to diminish his prospects by adopting a rule that would allow the Commissioner of Internal Revenue to assert and enforce a prior federal tax lien against that which "rightfully and completely belongs" to the victim. *Commissioner* v. *Wilcox, supra*, at 410. The CHIEF JUSTICE's opinion quite understandably expresses much concern for "honest taxpayers," but it attempts neither to deny nor justify the manifest injury that its holding will inflict on those honest taxpayers, victimized by embezzlers, who will find their claims for recovery subordinated to federal tax liens. Statutory provisions, by which we are bound, clearly and unequivocally accord priority to federal tax liens over the claims of others, including "judgment creditors."[4]

However, if it later happens that the debtor-creditor relationship between the embezzler and his victim is discharged by something other than full repayment, such as

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[4] 26 U. S. C. §§ 6321–6323, 6331; Bankruptcy Act, § 64 (a), 11 U. S. C. § 104 (a). Moreover, R. S. § 3466 (1875), now codified in 31 U. S. C. § 191, pertaining to state insolvency proceedings against debtors, commands that "the debts due to the United States shall be first satisfied." We long ago established that the term "debts" in this statute includes delinquent federal taxes. *Price* v. *United States*, 269 U. S. 492, 499–500. And even though the tax claim of the Government may be only a general lien, with notice thereof not yet filed in the proper local office pursuant to 26 U. S. C. § 6323, we have held that it must be accorded priority over the claims of all prior general lienholders, under R. S. § 3466, 31 U. S. C. § 191. *United States* v. *City of New Britain*, 347 U. S. 81, 84–85; *United States* v. *Gilbert Associates*, 345 U. S. 361, 366; *United States* v. *Texas*, 314 U. S. 480, 488. See Mertens, Law of Federal Income Taxation, § 12.103, note 67; *id.*, §§ 54.10–54.56.

by the running of a Statute of Limitations against the victim's claim, or by a release given for less than the full amount owed, the embezzler at that time, but not before, will have made a clear taxable gain and realized "an accession to income" which he will be required under full penalty of the law to report in his federal income tax return for that year. No honest taxpayer could be harmed by this rule.

The inherent soundness of this rule could not be more clearly demonstrated than as applied to the facts of the case before us. Petitioner, a labor union official, concededly embezzled sums totaling more than $738,000 from the union's funds, over a period extending from 1951 to 1954. When the shortages were discovered in 1956, the union at once filed civil actions against petitioner to compel repayment. For reasons which need not be detailed here, petitioner effected a settlement agreement with the union on July 30, 1958, whereby, in exchange for releases fully discharging his indebtedness, he repaid to the union the sum of $13,568.50. Accordingly, at least so far as the present record discloses, petitioner clearly realized a taxable gain in the year the releases were executed, to the extent of the difference between the amount taken and the sum restored. However, the Government brought the present action against him, not for his failure to report this gain in his 1958 return, but for his failure to report that he had incurred "income" from—actually indebtedness to—the union in each of the years 1951 through 1954. It is true that the Government brought a criminal evasion prosecution rather than a civil deficiency proceeding against petitioner, but this can in no way alter the substantive tax law rules which alone are determinative of liability in either case.

There can be no doubt that until the releases were executed in 1958, petitioner and the union stood in an absolute and unconditional debtor-creditor relationship, and

under all of our relevant decisions, no taxable event could have occurred until the indebtedness was discharged for less than full repayment. Application of the normal rule in such cases will not hinder the efficient and orderly administration of the tax laws, any more than it does in other situations involving "bargain cancellations" of indebtedness. More importantly, it will enhance the creditor's position by assuring that prior federal tax liens will not attach to the subject of the debt when he seeks to recover it.

Notwithstanding all of this, the CHIEF JUSTICE's opinion concludes that there is no difference between embezzled funds and "gains" from other "illegal sources," and it points to the fact that Congress, in its 1916 amendment of the 1913 Income Tax Act, omitted the word "lawful" in describing businesses whose income was to be taxed. The opinion then cites *United States* v. *Sullivan*, 274 U. S. 259, in which it was held that, under the amended statute, gains from illicit traffic in liquor must be reported in gross income, since there is no "reason why the fact that a business is unlawful should exempt it from paying the taxes that *if lawful* it would have to pay." *Id.*, at 263. (Emphasis added.) That theory has been the primary basis for taxing "unlawful gains of many kinds" which the prevailing opinion today recites, such as black market profits, gambling proceeds, money derived from the sale of unlawful insurance policies, etc.[1] For, even *if lawful*, the gains from such activities would clearly not be exempted from taxation. However, as applied to embezzled funds, the holding in *Sullivan* contradicts, rather than supports, the Court's conclusion today. Obvi-

[1] See cases cited in *Rutkin* v. *United States*, 343 U. S. 130, 137, note 8. See also *United States* v. *Brunwitz*, 219 F. 2d 59 (C. A. 2d Cir.); *Steinberg* v. *United States*, 14 F. 2d 564 (C. A. 2d Cir.); *Barker* v. *United States*, 26 F. Supp. 1004 (Ct. Cl.); *Silberman* v. *Commissioner*, 44 B. T. A. 600.

ously, embezzlement could never become "lawful" and still retain its character. If "lawful," it would constitute nothing more than a loan, or possibly a gift, to the "embezzler," neither of which would produce a taxable gain to him.

There is still another obvious and important distinction between embezzlement and the varieties of illegal activity listed by the prevailing opinion—one which clearly calls for a different tax treatment. Black marketeering, gambling, bribery, graft and like activities generally give rise to no legally enforceable right of restitution—to no debtor-creditor relationship which the law will recognize.[6] Condemned either by statute or public policy, or both, such transactions are void *ab initio*. Since any consideration which may have passed is not legally recoverable, its recipient has realized a taxable gain, an "accession to income," as clearly as if his "indebtedness" had been discharged by a full release or by the running of a Statute of Limitations. As we have already shown at length, quite the opposite is true when an embezzlement occurs; for then the victim acquires an immediately ripe and enforceable claim to repayment, and the embezzler assumes a legal debt equal to his acquisition.

To reach the result that it does today, the CHIEF JUSTICE's opinion constructs the following theory for defining taxable income:

> "When a taxpayer acquires earnings, lawfully or unlawfully, without the consensual recognition, express or implied, of an obligation to repay and without restriction as to their disposition, he has

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[6] Restatement, Contracts, § 598; 6 Corbin, Contracts, §§ 1373 *et seq.* (1951). That the rule applies even as to "unlawful insurance policies" is undoubted. Patterson, Essentials of Insurance Law (2d ed. 1957), § 43, at 186.

received income which he is required to return, even though it may still be claimed that he is not entitled to retain the money, and even though he may still be adjudged liable to restore its equivalent.' *North American Oil* v. *Burnet, supra*, at p. 424. In such case, the taxpayer has 'actual command over the property taxed—the actual benefit for which the tax is paid.' *Corliss* v. *Bowers, supra*. This standard brings wrongful appropriations within the broad sweep of 'gross income'; it excludes loans. When a law-abiding taxpayer mistakenly receives income in one year, which receipt is assailed and found to be invalid in a subsequent year, the taxpayer must nonetheless report the amount as 'gross income' in the year received. *United States* v. *Lewis, supra*; *Healy* v. *Commissioner, supra*."

This novel formula finds no support in our prior decisions, least of all in those which are cited. *Corliss* v. *Bowers*, 281 U. S. 376, involved nothing more than an *inter vivos* trust created by the taxpayer to pay the income to his wife. Since he had reserved the power to alter or abolish the trust at will, its income was taxable to him under the express provisions of § 219 (g), (h) of the Revenue Act of 1924. *North American Oil* v. *Burnet*, 286 U. S. 417, is the case which introduced the principle since used to facilitate uniformity and certainty in annual tax accounting procedure, *i. e.*, that a taxpayer must report in gross income, in the year in which received, money or property acquired under a "claim of right"—a colorable claim of the right to *exclusive possession* of the money or property. Thus, in its complete form, the sentence in *North American Oil* from which the above-quoted fragment was extracted reads: "If a taxpayer receives *earnings under a claim of right* and without restriction as to its [*sic*] disposition, he has received

income which he is required to return, even though it may still be claimed that he is not entitled to retain the money, and even though he may still be adjudged liable to restore its equivalent." *Id.*, at 424. (Emphasis added.) But embezzled funds, like stolen property generally, are not "earnings" in any sense and are held without a vestige of a colorable claim of right; they constitute the principal of a debt. Of no significance whatever is the formality of "consensual recognition, express or implied" of an obligation to repay. By substituting this meaningless abstraction in place of the omitted portion of the *North American Oil* test of *when* a receipt constitutes taxable income, the prevailing opinion today goes far beyond overruling *Wilcox*—it reduces a substantial body of tax law into uncertainty and confusion. The above-cited case of *United States* v. *Lewis*, 340 U. S. 590, decided 19 years after *North American Oil*, demonstrates the truth of this. For there we said:

> "The 'claim of right' interpretation of the tax laws has long been used to give finality to [the accounting] period, and is now deeply rooted in the federal tax system. . . . We see no reason why the Court should depart from this well-settled interpretation merely because it results in an advantage or disadvantage to a taxpayer." 340 U. S. at 592.

The same principle was reiterated and applied in *Healy* v. *Commissioner*, 345 U. S. 278.

The supposed conflict between *Wilcox* and *Rutkin*, upon which the CHIEF JUSTICE's opinion seeks to justify its repudiation of *Wilcox*,[1] has been adequately treated in

[1] I cannot agree with the CHIEF JUSTICE's assertion that *Wilcox* has been "thoroughly devitalized" by *Rutkin*. See, *e. g.*, the recent case of *United States* v. *Peelle*, 159 F. Supp. 45 (D. C. E. D. N. Y., 1958). There the Government sought to enforce liens for federal income taxes claimed to be due on items of "income" aggregating $678,461.22.

the opinion of MR. JUSTICE BLACK, and I agree with him that those cases were fully intended to be, and are, reconcilable, both on their controlling facts and applicable law. If the unnecessarily broad language used in the *Rutkin* opinion has misled any of the lower federal courts in their understanding of the principles underlying *Wilcox*, we should clarify their understanding at this time, and continue our adherence to "a prior doctrine more embracing in scope, intrinsically sounder, and verified by experience." *Helvering* v. *Hallock*, 309 U. S. 106, 119.

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which the taxpayer had embezzled from his corporate employer during the years 1945 through 1949. The items in question consisted of customers' payments intended for the corporation, and had been embezzled by the taxpayer and kept by him in secret bank accounts. In 1951 and 1952, he discharged his indebtedness by making full restitution of the embezzled funds to the corporation. The corporation, which used the accrual method of accounting, paid deficiencies which the Government determined in its 1945-1949 income tax returns, based on its accrued right to receive the embezzled customers' payments in those years. Not satisfied with this, the Government took the position that the payments were taxable *twice* during the same years—once to the corporation when it accrued the right to receive them, and again to the embezzler when he diverted them into the secret bank accounts. Had this effort at double taxation succeeded, the Government's combined tax claims would have been far in excess of the amount being taxed.

In rejecting the Government's argument that the embezzler received taxable income at the time of the embezzlements, the District Court relied wholly upon the decision which the Court today overrules, *Commissioner* v. *Wilcox*, *supra*.